87-363 (1)

No.

In the Supreme Court of the United States

OCTOBER TERM, 1987

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

MARTIN EXPLORATION MANAGEMENT COMPANY, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether, as the Federal Energy Regulatory Commission determined, natural gas that is covered by two provisions of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*—one of which sets a ceiling on prices, the other of which declares prices deregulated—must be treated as deregulated gas under the NGPA; or whether, instead, producers may choose, perhaps daily, the classification that, under current market conditions and their contracts, affords them the highest price.

2. Whether the Commission's ruling that most "new tight formation gas" under Section 107(c)(5) of the NGPA is automatically new gas under Section 102 or 103 of the Act is consistent with the Commission's authority under the NGPA.

PARTIES TO THE PROCEEDINGS

The petitioner is the Federal Energy Regulatory Commission. The respondents are Martin Exploration Management Company; Colorado Energy Corporation; Phillips Petroleum Company; Phillips Oil Company; Exxon Corporation; Shell Off-Shore, Inc.; Shell Western E & P, Inc.; Independent Oil & Gas Association of West Virginia; Amoco Production Company; Arco Oil & Gas Company; Ohio Oil and Gas Association; Independent Oil and Gas Association of West Virginia; Gulf Oil Corporation, successor to Chevron, U.S.A., Inc.; Union Oil Company of California; Champlin Petroleum Company; Pennzoil Company; Pennzoil Oil & Gas, Inc.; Pennzoil Producing Company; Placid Oil Company; Tennessee Gas Pipeline Company, a division of Tenneco, Inc.; Pacific Gas & Electric Company; Amoco Production Company; Transok, Inc.; Oklahoma Natural Gas Company, a division of Oneok, Inc.; Associated Gas Distributors; Public Service Commission of the State of New York; Pacific Lighting Gas Supply Company; Southern California Gas Company; Consolidated Gas Transmission Corporation; Panhandle Eastern Pipe Line Company; Cities Service Oil and Gas Corporation; Grace Petroleum Corporation; Valero Transmission Company; BHP Petroleum Company, Inc., successor to Monsanto Oil Company; Texas Eastern Transmission Corporation; Transwestern Pipeline Company; United Gas Pipe Line Company; United Texas Transmission Company; and Texas Gas Transmission Corporation.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The Solicitor General, on behalf of the Federal Energy Regulatory Commission (Commission or FERC), petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-28a) is reported, as modified, at 813 F.2d 1059. The order of the court of appeals modifying the original opinion (App., *infra*, 29a-31a) is not separately reported. The notice of proposed rulemaking of FERC (App., *infra*, 34a-60a) is reported at 49 Fed. Reg. 36399. The opinion accompanying issuance of the final rule by FERC (App., *infra*, 61a-103a) is reported at 49 Fed. Reg. 46874 and F.E.R.C. Stats. and Regs. para. 30,613. The FERC opinion denying rehearing in relevant part (App., *infra*, 104a-126a) is reported at 49 Fed. Reg. 50637 and F.E.R.C. Stats. and Regs. para. 30,622.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 32a-33a) was entered on March 9, 1987. Petitions for rehearing were denied, with modifications of the original

decision, on May 1, 1987 (App., *infra*, 29a-31a). On July 22, 1987, Justice White extended the time for filing a petition for a writ of certiorari to and including August 31, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

Sections 101(b)(5), 107(c)(5), 121, and 122 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3311(b)(5), 3317(c)(5), 3331, 3332, are set out in the appendix to this petition (App., *infra*, 127a-131a).

Section 270.208 of 18 C.F.R. provides:

> First sales of natural gas that is deregulated natural gas as defined in § 272.103(a) is price deregulated and not subject to the maximum lawful prices of the NGPA, regardless of whether the gas also meets the criteria for some other category of gas subject to a maximum lawful price under Subtitle A of Title I of the NGPA.

STATEMENT

The Commission construed the NGPA to require, in accordance with the Act's overall scheme of phased-in deregulation, that natural gas that is qualified for both price-deregulated and price-regulated status under the Act be treated as deregulated. The court of appeals rejected the Commission's construction (App., *infra*, 10a). The court held that producers of natural gas could choose whatever statutory category afforded them the highest price under their contracts and market conditions at any particular moment, even if the choice meant returning deregulated gas to regulated status (*id.* at 17a, 30a).

A. *Statutory Background*

1. Prior to 1978, producer (wellhead) natural gas sales, if made in interstate commerce, were governed by the Natural Gas Act, 15 U.S.C. 717 *et seq.* Following this

Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), the Federal Energy Regulatory Commission (and its predecessor, the Federal Power Commission) established just-and-reasonable ceiling rates for such sales. Those rates were generally lower than what producers could command selling gas in the unregulated, intrastate market. See *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 327-331 (1983). "By the 1970's, however, it became clear that the existing regulatory structure was inadequate" (App., *infra*, 3a). The combination of price ceilings applicable to interstate sales and no constraints on intrastate sales artificially reduced supply and inflated demand in the interstate market. *Ibid.*; Breyer & MacAvoy, *The Natural Gas Shortage and the Regulation of Natural Gas Producers*, 86 Harv. L. Rev. 941 (1973); Note, *Legislative History of the Natural Gas Policy Act: Title I*, 59 Tex. L. Rev. 101, 106-112 (1980).

In 1977, the House and Senate each passed bills designed to address the problem. The House, as part of a broader National Energy Act, passed a bill that would have extended regulatory controls by imposing uniform price regulation, at levels aimed at encouraging production, on all natural gas, interstate or intrastate (H.R. 8444, 95th Cong., 1st Sess. (1977)). The Senate took a radically different approach. It passed a bill (S. 2104, 95th Cong., 1st Sess. (1977)) that provided for deregulation of all natural-gas prices by 1982, with certain price controls in the interim. See *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. at 331-332; Note, *supra*, 59 Tex. L. Rev. at 113-115.

The conflict between the houses went to a Conference Committee, which proposed an entirely new bill roughly one year later (H.R. 5289, 95th Cong., 2d Sess. (1978); H.R. Conf. Rep. 95-1752, 95th Cong., 2d Sess. (1978)). The conference bill struck a compromise between the

House's proposed increased regulation and the Senate's proposed rapid deregulation (see H.R. Conf. Rep. 95-1752, *supra*, at 67-68; 124 Cong. Rec. 38361 (1978) (remarks of Rep. Dingell); *Public Service Comm'n* v. *Mid-Louisicna Gas Co.*, 463 U.S. at 331)). The bill brought interstate and intrastate gas under a single " 'national market price regulatory scheme' " (*Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd. (Transco)*, No. 84-1076 (Jan. 22, 1986), slip op. 11, quoting Haase, *The Federal Role in Implementing the Natural Gas Policy Act of 1978*, 16 Hous. L. Rev. 1057, 1079 (1979)); replaced Commission-set ceilings (at "just and reasonable" rates) with price ceilings generally set directly by statute, many designed to provide incentives for new production; and mandated "deregulation of most categories of natural gas" (H.R. Conf. Rep. 95-1752, *supra*, at 68) after a transition period of up to nine years. See Note, *supra*, 59 Tex. L. Rev. at 116. Enacted as the NGPA, the bill thus "comprehensively and dramatically changed the method of pricing natural gas produced in the United States" (*Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. at 322).

2. Title I of the NGPA creates the scheme of "phased deregulation" (124 Cong. Rec. 38361 (1978) (remarks of Rep. Dingell)) in two stages. Subtitle A (NGPA §§ 101-110, 15 U.S.C. 3311-3320) defines numerous categories of natural gas and establishes (or, in a few exceptional cases, permits the Commission to set) "maximum lawful price[s]" for wellhead "first sale[s]" of gas in each category.[1] Subtitle B (NGPA §§ 121-123 (15 U.S.C. 3331-3333)) then provides for the removal of certain of those ceilings after periods ranging from several months to nine years.

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[1] A "first sale" is most often, but not exclusively, a sale by the producer of the natural gas (NGPA § 2(21), 15 U.S.C. 3301(21)).

More particularly, Subtitle A defines numerous categories of natural gas,[2] which, aside from a catch-all residual category (NGPA § 109 (15 U.S.C. 3319)), fall roughly into three groups. (1) Four provisions set prices (or authorize the Commission to do so) that are designed to furnish incentives for new production: Sections 102 and 103 (15 U.S.C. 3312, 3313) cover certain new natural gas[3]; Section 107 (15 U.S.C. 3317) covers certain "high-cost" natural gas[4]; Section 108 (15 U.S.C. 3318) covers gas from certain low-producing "stripper" wells.[5] (2) Two provisions (§§ 104 and 106(a), 15 U.S.C. 3314, 3316(a)) cover "old" interstate gas—gas dedicated to interstate commerce prior to NGPA's effective date or sold under "rollover" interstate contracts—and set non-incentive, consumer-protection price ceilings based on the Natural Gas Act. (3) Two provisions (§§ 105 and 106(b), 15 U.S.C. 3315, 3316(b)) cover "old" intrastate gas—defined analogously to "old" interstate gas—and set price ceilings tied to those for "new" Section 102 gas.

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[2] The category-defining sections are Sections 102-109 (15 U.S.C. 3312-3319). Section 101 (15 U.S.C. 3311) defines the annual inflation adjustment factor and other "[r]ules of general application" relevant to the remainder of the Act. Section 110 (15 U.S.C. 3320) concerns the treatment of state severance taxes and certain production-related costs.

[3] Section 102 (15 U.S.C. 3312) covers gas from a new reservoir, from certain new Outer Continental Shelf leases, or from a new well drilled sufficiently far from certain existing "marker" wells. Section 103 (15 U.S.C. 3313) covers certain new onshore production wells.

[4] Section 107 (15 U.S.C. 3317) defines four categories of high-cost gas (Subsections (c)(1) through (4)) and allows the Commission to designate other gas that is especially costly or risky to produce (Subsection (c)(5)).

[5] A "stripper" well is one that produces 60 Mcf or less per day. See NGPA § 108(b), 15 U.S.C. 3318(b); NGPA § 2(29) (15 U.S.C. 3301(29)) (defining "Mcf").

Section 121 (15 U.S.C. 3331), the central provision of Subtitle B, mandates the elimination of price ceilings for certain of the categories of natural gas specified in Subtitle A.[6] Most important, on January 1, 1985, price ceilings were eliminated from certain of the incentive-priced gas qualifying under Sections 102 and 103 ("new" gas) and under Sections 105 and 106(b) ("old" intrastate gas) (15 U.S.C. 3312, 3313, 3315, 3316(b)).[7] See NGPA § 121(a), 15 U.S.C. 3331(a).[8] Some gas, however—notably, certain "high-cost" gas (Subsection 107(c)(5), 15 U.S.C. 3317(c)(5)) and "stripper well" gas (Section 108, 15 U.S.C. 3318)—remains subject to price ceilings. Section 122 (15 U.S.C. 3332) completes the deregulation scheme by giving the President and Congress an option for a one-time 18-month reimposition of price controls, an option that expired on June 30, 1987, without having been invoked.

3. The categories defined by the provisions of Subtitle A overlap: substantial quantities of natural gas can qualify

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[6] Specifically, Section 121(a) states: "Subject to the reimposition of price controls as provided in section 122, the provisions of subtitle A respecting the maximum lawful price for the first sale of each of the following categories of natural gas shall, except as provided in subsections (d) and (e), cease to apply effective January 1, 1985 * * *."

Subsection (d) is not relevant to this case. Subsection (e) limits the deregulation of one category (§ 105(b)(3), 15 U.S.C. 3315(b)(3)) of gas. See note 24, *infra*.

[7] Certain "old" intrastate gas covered by Section 105 continues to be subject to price ceilings. See NGPA § 121(e) (15 U.S.C. 3331(e)).

[8] In addition, pursuant to Section 121(b) (15 U.S.C. 3331(b)), on November 1, 1979, price ceilings were removed from some "high-cost" gas under Section 107(c)—namely, gas under Subsections (c)(1)-(4) (15 U.S.C. 3317(c)(1)-(4)). (Gas under Subsection (c)(5) (15 U.S.C. 3317(c)(5)) remains subject to price ceilings.) Also, on July 1, 1987, price ceilings were removed from "new" Section 103 gas produced from shallow wells never previously dedicated to interstate commerce. See NGPA § 121(c), 15 U.S.C. 3331(c).

simultaneously under more than one provision.[9] In addition to the overlap of several regulated categories, there is overlap between categories that remain subject to price ceilings (regulated gas) and categories that are free from any maximum lawful price (deregulated gas). For example, the categories defined by Sections 107(c)(5) and 108 (15 U.S.C. 3317(c)(5), 3318) (certain high-cost natural gas and stripper-well gas), which remain subject to price ceilings, overlap significantly with the new-gas categories defined by Sections 102 and 103 (15 U.S.C. 3312, 3313), which are now deregulated. See App., *infra*, 43a, 73a.

The NGPA contains a provision addressed to the general question of such "dual-qualified" gas. In Section 101(b) (15 U.S.C. 3311(b)), which sets forth "Rules of general application," Subsection (b)(5) states:

> (5) Sales qualifying under more than one provision.—If any natural gas qualifies under more than one provision of this title providing for any maximum lawful price or for any exemption from such a price with respect to any first sale of such natural gas, the provision which could result in the highest price shall be applicable.[10]

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[9] Pursuant to NGPA § 503, 15 U.S.C. 3413, producers obtain rulings on the proper classification or classifications of "new," high-cost and stripper-well gas from certain state or federal agencies, subject to Commission review. Dual qualification is permitted. See 124 Cong. Rec. 38364 (1978) (explanatory statement on conference bill by Reps. Dingell, Staggers, Ashley, Eckhardt, and Wilson).

[10] The Conference Report explains (H.R. Conf. Rep. 95-1752, *supra*, at 74):

> The conference agreement provides that if natural gas qualifies under more than one price category, the provisions that permit the seller to obtain the highest price applies [*sic*]. If a seller wishes to change the category under which production from a given well qualifies, he must apply to the appropriate State or federal agency with authority to make determinations under section 503.

B. *The Commission's Rules*

As the principal deregulation date (January 1, 1985) approached, the Commission found it necessary to consider the proper treatment of gas that qualified for both regulated and deregulated treatment. At the time the NGPA was enacted in 1978, it appears to have been universally assumed that market prices would be higher than the statutory ceilings, so that producers would prefer deregulated treatment. By the end of 1984, this situation had been reversed. See App., *infra*, 22a-23a. Consequently, many producers preferred their dual-qualified regulated-deregulated gas to be treated as still subject to a regulated price.[11] See App., *infra*, 73a-78a.

In September 1984 the Commission proposed a regulation to determine the legal treatment of gas that is qualified for both deregulated and regulated treatment.[12] App., *infra*, 43a-45a. After receipt of comments, the Commission, in November 1984, issued a final rule establishing that, as of January 1, 1985, gas that is

[11] Many producers have contracts that fix the price of their gas far into the future, often providing alternative prices depending on the regulatory classification of the gas and leaving it up to government action (statute, regulation, order) to determine the classification of the gas. The price fixed for regulated gas is commonly at or near the maximum lawful price. By contrast, the price for gas treated as not subject to a price ceiling is typically based on market prices. As a result, when market prices are below the statutory ceilings, many producers wish to have their gas treated as falling within one of the still-regulated categories, so that they can collect a higher price.

[12] The Commission addressed only gas that actually is qualified in two categories by the relevant state or federal agency (insofar as qualification is needed for sale in a category), not all gas that could conceivably be so qualified. See 18 C.F.R. 270.208, referring to 18 C.F.R. 272.103(a), which defines deregulated gas to include only gas actually qualified by the relevant agency (and certain "old" intrastate gas, which need not be so qualified).

Certain other issues were addressed in the rulemaking proceeding and in the court of appeals. We discuss only the dual-qualification questions.

qualified for a category not subject to any price ceiling would be treated as deregulated and could be sold at any price the market would bear, even if the gas also is qualified for one of the categories still subject to statutory price ceilings. App., *infra*, 73a-82a; see page 2, *supra* (quoting rule, 18 C.F.R. 270.208). Noting that market prices were then below statutory ceiling prices, that "Congress may not have anticipated such a situation" (App., *infra*, 75a), and that many producers would therefore prefer to remain subject to price regulation, the Commission construed the NGPA to mandate deregulation.[13]

The Commission based this conclusion, first, on Section 121 of the NGPA (15 U.S.C. 3331), which by its terms mandates the removal of Subtitle A's price ceilings for the specified categories of natural gas. The Commission read the provision to embody Congress's mandate to "phase from regulated ceiling prices in the short term to market clearing prices in the long term" (App., *infra*, 76a). See App., *infra*, 75a-77a. The Commission pointed out (App., *infra*, 74a; see also App., *infra*, 43a) that "the overall scheme envisioned by Congress when it enacted the NGPA [was] to provide incentive prices to encourage exploration and development of new reserves in the short-term, and to gradually substitute market forces for regulated prices by phasing in deregulation in 1985 and 1987."

The Commission likewise construed Section 101(b)(5) (15 U.S.C. 3311(b)(5)) to require deregulated treatment of gas that falls under both a provision setting a ceiling price and one eliminating any legal ceiling price (App., *infra*, 78a-79a).[14] The Commission concluded that Section

[13] The Commission also noted that, in 1979 and 1980, when market conditions were different, several producers, including some of respondents here, specifically argued in favor of the construction of the NGPA adopted by the Commission in the proceedings at issue in this petition. App., *infra*, 74a & n.10.

[14] The Commission stated that the provision was "helpful, but not dispositive" of the issue (App., *infra*, 78a).

101(b)(5), in declaring applicable whichever of the competing provisions "could result in the highest price," means that "the deregulated price, which always *could* result in a price *higher* than a regulated price, prevails" because "there always exists at least the potential for the parties to negotiate a contract above the old regulated ceiling price" (App., *infra*, 79a (emphasis in original)). The Commission further explained on rehearing (App., *infra*, 111a (footnote omitted; emphasis in original)): "Without question, a deregulated price *could* always result in a price higher than a regulated price which is subject to a ceiling price; whether the *contract* allows the producer to collect a price higher than a regulated price is a contractual issue, not an issue raised by the deregulation scheme of the NGPA."[15]

C. *The Court of Appeals Decision*

On petitions for review filed by numerous producers under Section 506 of the NGPA (15 U.S.C. 3416), the court of appeals rejected the Commission's interpretation of Sections 101(b)(5) and 121 (15 U.S.C. 3311(b)(5), 3331) of the NGPA. App., *infra*, 1a-24a. The court first concluded that Section 121 is ambiguous, because, although it commands the elimination of price ceilings for the listed categories of natural gas, it does not explicitly address the subject of deregulated gas that simultaneously qualifies for a regulated category (App., *infra*, 10a-11a). The court then stated that, despite the ambiguity, it could not defer to the Commission's interpretation, because "Congress

[15] In the course of explaining its rule for the treatment of dual-qualified regulated-deregulated gas, the Commission also ruled (App., *infra*, 81a-82a; see also App., *infra*, 114a-116a) that any qualification of gas as "new tight formation" gas under Section 107(c)(5) and the implementing regulations (*e.g.*, 18 C.F.R. 271.703(b)) automatically qualifies the gas (except for certain "recompletion tight formation gas," App., *infra*, 82a n.18)) as new gas under Section 102 or 103, hence placing it under deregulation.

anticipated precisely this question in § 101(b)(5)" (App., *infra*, 11a) and the Commission's ruling was contrary to the "unambiguous language" of that provision (App., *infra*, 13a).

After concluding that Section 101(b)(5) applies to all dual-qualified gas, even if one of the overlapping categories is deregulated,[16] the court held that the "could result" language of Section 101(b)(5) expressly and unambiguously gives producers the right to choose, at any particular moment, whatever category, regulated or deregulated, provides the highest price under their contracts. App., *infra*, 16a-17a; *id.* at 30a (modification on petitions for rehearing). While recognizing that "the price of deregulated natural gas in an open market 'could' theoretically reach infinity" (App., *infra*, 15a), the court reasoned that at least certain price ceilings for regulated gas "could" also rise indefinitely.[17] The court stated that the Commission's reading of Section 101(b)(5) "considers only the theoretical possibilities [and] renders § 101(b)(5)

[16] The court reasoned that Section 101(b)(5), in using the word "exemption" when referring to provisions "providing for any maximum lawful price or for any exemption from such a price," applies to statutory provisions declaring gas prices deregulated. The court rejected the suggestion that the term "exemption" applies only to the provisions (§§ 104(b)(2), 106(c), 109(b)(2), 15 U.S.C. 3314(b)(2), 3316(c), 3319(b)(2)) that grant the Commission authority to set special "just and reasonable" ceilings higher than statutory ceilings for particular categories. The court pointed out that another of the "Rules of general application"—namely, Section 101(b)(9) (15 U.S.C. 3311(b)(9))—uses "exempted" and "exemption" to refer to provisions that deregulate gas prices (App., *infra*, 14a-15a).

[17] The court noted that the Commission could set price ceilings at "just and reasonable" rates under certain regulated-price provisions (§§ 104(b)(2), 106(c), 109(b)(2), 15 U.S.C. 3314(b)(2), 3316(c), 3319(b)(2)) and that the Subtitle A ceiling prices generally rise with inflation. "The price of regulated gas is therefore certain to rise, and is capable of reaching an indefinite 'just and reasonable' rate." App., *infra*, 15a-16a.

meaningless" (App., *infra*, 16a). The court concluded that Section 101(b)(5) "requires a comparison of the applicable price for each category at a particular moment" based on producers' actual contracts (App., *infra*, 16a), with the higher price governing (*id.* at 16a-17a).

In support of that conclusion, the court indicated that it read the NGPA, informed by several congressional floor statements, as granting a producer the right to "select the category or categories for which he or she desires to qualify particular gas" (App., *infra*, 19a). See App., *infra*, 18a-19a (citing 124 Cong. Rec. 29109 (1978) (remarks of Sen. Jackson); *id.* at 38363-38364 (remarks of Rep. Dingell)).[18] The court also criticized the Commission's reliance on phased deregulation as the overall plan of the NGPA. Phased deregulation is only one means of achieving the ultimate statutory aim of ensuring adequate supplies at fair prices, the court stated (App., *infra*, 20a). Briefly mentioning a few statements from the NGPA's legislative history (App., *infra*, 21a-22a n.15), the court noted that the cited passages had "somewhat contradictory" implications (*id.* at 21a n.15). Indeed, the court recognized that "Congress did not expect that natural gas prices would fall" and hence did not anticipate the situation presented to the Commission in 1984 and today—that of producers wishing to remain under regulation (*id.* at

[18] The court expressed this view in rejecting the Commission's ruling that most Section 107(c)(5) "new tight formation" gas (15 U.S.C. 3317(c)(5)) is automatically also gas under Section 102 or 103 (15 U.S.C. 3312, 3313), a ruling that both the Commission and the court treated as part of the broader dual-qualification ruling (App., *infra*, 18a-19a; see note 15, *supra*). The court agreed that, with the "recompletion" exception acknowledged by the Commission (see note 15, *supra*), new tight formation gas in fact always meets the definitions under Section 102 or 103. But the court held that Congress had given producers the right to choose what categories to apply for, so that they could avoid qualification as deregulated gas if they wished.

22a-23a). The court of appeals also recognized that, under its view, Section 101(b)(5) "can have the unanticipated effect of operating as a price floor for producers" (App., *infra*, 23a). Nevertheless, the court felt itself bound by "the intent of Congress as evidenced in the unambiguous language of [the NGPA]" (App., *infra*, 24a).

REASONS FOR GRANTING THE PETITION

The Tenth Circuit decision is clearly incorrect. The Commission properly concluded, in construing a statute it is charged with administering, that Section 101(b)(5) of the NGPA requires price deregulation for gas that is qualified for both a regulated and a deregulated category.[19] The decision of the court of appeals, if permitted to stand, would impose enormous additional costs on purchasers of natural gas.

1. To begin with the statutory language, the most natural reading of Section 101(b)(5) is that, if natural gas is subject to two or more provisions of the NGPA, the "provision which could result in the highest price" is the provision that, solely with reference to limits imposed under the NGPA, permits the highest price. See also H.R. Conf. Rep. 95-1752, *supra*, at 74 (emphasis added) ("the provisions that *permit* the seller to obtain the highest price"). Section 101(b)(5) thus calls for a comparison of existing legal limits on the prices producers may charge (in most cases set directly by the NGPA, in some cases set by

[19] We do not renew the argument we made in the court of appeals that Section 101(b)(5) does not apply to dual-qualified regulated-deregulated gas.

In addition to the court of appeals' dual-qualification holding, we also challenge the court's holding concerning the treatment of Section 107(c)(5) gas. The court did not treat that issue as a distinct one. We present the question separately (page I, *supra*), but it is closely related to the main question and warrants only brief discussion. See note 23, *infra*.

the Commission pursuant to statutorily delegated authority). Where one provision sets a maximum lawful price and another declares that there is no such ceiling, the latter provision governs because it leaves the producers free to charge the higher price—namely, any price, as far as the NGPA is concerned.

Contrary to the court of appeals' view, the statutory language contains no hint that it calls for comparison of producers' contracts. Section 101(b)(5) refers only to comparing "provision[s]," not to comparing contracts. Moreover, the use of the statutory phrase "could result" is inconsistent with a focus on actual contract prices. To achieve the court of appeals' result, it would have been more natural for Congress to have declared applicable the provision that "results" or that "would result" in the highest price. Congress instead used the word "could," referring to the range of legally permitted possibilities.

The court of appeals appears to have misunderstood the Commission's construction, and was plainly mistaken in concluding that the Commission's view rendered Section 101(b)(5) meaningless (App., *infra,* 15a-16a). A provision that eliminates price ceilings always permits the seller to obtain, *i.e.,* always "could result" in, a higher price than a provision that, directly or through statutorily delegated Commission action, sets an upper cap on producers' prices. The Commission's interpretation leaves no doubt about which provision governs under Section 101(b)(5). The court of appeals' reference to the Commission's power to set certain "just and reasonable" rates and to the raising of ceiling prices by inflation adjustments over time (see note 17, *supra*) was simply irrelevant. Section 101(b)(5) is not concerned with "theoretical" possibilities at a particular moment or over an indefinite period. It is concerned only with what the law permits, not with what market conditions or imagination permit. A provision that removes upper caps permits a higher price than one that

sets an upper cap (even if that cap is adjustable), and the former provision therefore governs under Section 101(b)(5).

2. The court of appeals' focus on producers' actual contract prices (and their fluctuation) is inconsistent not only with the language of Section 101(b)(5) but with the approach to price regulation taken by Title I of the NGPA as a whole. As reflected in the Commission's view, the NGPA regulates only legal upper limits, not producers' actual prices. Thus, the price-regulation provisions of Subtitle A do not establish the prices that producers must charge; rather, they are concerned solely with setting "maximum lawful price[s]" or "ceiling prices." Section 504(a) (15 U.S.C. 3414(a)) enforces the ceilings by declaring it unlawful "to sell natural gas at a first sale price in excess of any applicable maximum lawful price." Moreover, to underscore the exclusive concern with upper limits, Section 101(b)(9) (15 U.S.C. 3311(b)(9)) expressly declares that contract prices are enforceable as long as they are lower than any applicable statutory ceiling, and are always lawful if a price-deregulation provision applies. Congress clearly sought to set only maximum prices and otherwise to leave the establishment of the prices producers would actually charge to private decision.

The court of appeals read Section 101(b)(5) to require comparison of producers' actual contract prices, rather than of upper caps on the range of legally permitted prices. That reading would erroneously treat Section 101(b)(5) as specifying the actual prices producers must charge—namely, the highest of the applicable contract prices. It would do so, moreover, even when the two overlapping categories at issue both set ceiling prices (*i.e.,* in the case of dual-qualified regulated-regulated gas), requiring comparison not of the ceilings but of the actual contract prices. Nothing in the statute or in the court of appeals' opinion supports such a result. Indeed, it is

squarely contrary to the fact that Section 101(b)(5) does not establish the governing price but only declares what "provision" governs, and that the provisions of Title I, in turn, establish only ranges of legally permitted prices. See also 124 Cong. Rec. 38363 (1978) (emphasis added) (Section 101(b)(5) "is intended to facilitate resolution of which *ceiling price* may apply if more than one ceiling price rule appears applicable. Whichever *ceiling price* could result in the highest price is the applicable *maximum lawful price.*") In short, the court of appeals' reading of Section 101(b)(5) would render the provision a glaring anomaly in a statute otherwise pervasively concerned only with ceiling prices.

3. The court of appeals' ruling is also inconsistent with the fundamental policy underlying the NGPA. The clear overall scheme of the NGPA is one of "phased deregulation" (124 Cong. Rec. 38361 (1978) (remarks of Rep. Dingell); see also *id.* at 29659 (remarks of Sen. Percy) ("the phased deregulation schedule * * * really is at the heart of this bill"). The Conference Report describes Title I of the NGPA as providing for the eventual "deregulation of most categories of natural gas" (H.R. Conf. Rep. 95-1752, *supra,* at 68). That policy reflected Congress's belief, as this Court recognized in *Transco,* slip op. 14 (footnote omitted), that "direct federal price control exacerbated supply and demand problems by preventing the market from making long-term adjustments." Congress decided to phase in deregulation over a nine-year period as a compromise between "two strong, but divergent, responses to the natural gas shortage" (*Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. at 331), one seeking to extend price controls (the House bill), the other seeking full decontrol as quickly as possible (by 1982, under the Senate bill). See Lovett, *Incentive and Conservation Effects: Natural Gas Policy Act of 1978,* 16 Hous. L. Rev. 1129, 1145 (1979).[20] To the extent that Congress deregulated "particular aspects of the first sale of gas, it did so because [after the specified phase-in periods] it wanted to leave determination of supply and first-sale price to the market" (*Transco,* slip op. 12).

Contrary to the court of appeals' view, it was proper for the Commission to support its ruling by observing that treating dual-qualified regulated-deregulated gas as deregulated is in keeping with Congress' overall phased-deregulation objective of the NGPA. The court of appeals' interpretation of Section 101(b)(5), by contrast, is incompatible with the congressional scheme. The court's decision establishes a uniform and permanent producer-assistance policy. But while the temporary incentive-price provisions of the NGPA were indeed intended to spur production, the deregulation policy that has now been phased in for most categories of gas is not intended to favor producers or production. Rather, deregulation is designed to let market forces determine prices and supply (see *Transco,* slip op. 12), and lower prices and lower production are one possible natural consequence of such a system.

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[20] The Conference Committee obviously adopted elements of both bills, bringing intrastate gas under control while "lengthening the period of time prior to the deregulation of most categories of natural gas" (H.R. Conf. Rep. 95-1752, *supra,* at 68). Representative Dingell, who was the floor manager of the Conference bill in the House, explained that, although he had opposed immediate deregulation for fear of its harsh consequences to consumers and potential for windfall profits, "[p]hased deregulation as set forth in the conference report avoids both of these objectionable results" (124 Cong. Rec. 38361 (1978)). On the compromise nature of the bill, see Allison, *Natural Gas Pricing: The Eternal Debate,* 37 Baylor L. Rev. 1, 37 (1985); Pierce, *Natural Gas Regulation, Deregulation and Contracts,* 68 Va. L. Rev. 63, 89 (1982); Moody & Garten, *The Natural Gas Policy Act of 1978: Analysis and Overview,* 25 Rocky Mtn. Min. L. Inst. 2-1, 2-39, 2-40 (1979); Lovett, *supra,* 16 Hous. L. Rev. at 1152.

The court of appeals' reading of Section 101(b)(5) is incompatible with the scheme of phased deregulation in another way as well. The court's reading would permit a producer to switch back and forth between deregulated and regulated status, with no apparent limitation, as market prices rose or fell. The potential for return of deregulated gas to regulated status is a continuing one, because deregulated "new" gas (under Sections 102 and 103 (15 U.S.C. 3312, 3313)) will always become regulated "stripper well" gas (under Section 108 (15 U.S.C. 3318)) as the well diminishes in production. There is certainly no indication that the NGPA contemplates such a peculiar result. Indeed, the congressional aim to make a transition to a market system for most natural gas strongly suggests the contrary. The intended transition is reflected in Section 122 (15 U.S.C. 3332), which establishes only one method to call off deregulation (action by the President or Congress), and then only temporarily and only once.

4. The court of appeals also erred in finding that its ruling was supported by a congressional commitment to the principle of producer choice. The language of Section 101(b)(5) itself refutes the suggestion that the statute embodies such a principle for dual-qualified gas. The provision declares what price provisions govern; it does not give producers any choice in the matter. The court of appeals' reference to producers' right to choose which among several available qualifications to apply for, whatever its correctness, is simply irrelevant. The Commission's rule here at issue applies, among gas that is required to be administratively qualified, only to gas that has in fact been dually qualified in both regulated and deregulated categories. See note 12, *supra*. Whether producers have an indefeasible right to select one or more applicable categories in qualifying their gas under Section 503 (15 U.S.C. 3413)[21] is entirely distinct from the question

[21] In our view, nothing in Section 503, which provides for administrative determinations of the proper category of natural gas, grants producers the indefeasible right to select one of two applicable

presented in this proceeding—which of several already-selected categories applies after deregulation. The former question is also of little remaining practical importance, in comparison with the question presented here.[22]

The two congressional floor statements cited by the court of appeals (App., *infra*, 18a-19a), even aside from questions about their power to modify the statute's command, do not establish a relevant statutory principle of producer choice. First, they are addressed not to the question at issue here but to the distinct question of producers' ability to select what qualifications to seek. Second, both statements, responding to concerns about the potential administrative burdens on the agencies that determine the classification of natural gas, merely affirm that the agencies have no statutory obligation to search through all possible classifications, demand all potentially relevant information from producers, and independently determine

categories. Indeed, the authority of the Commission to promulgate regulations under Sections 501(a) and (b) and 503(b) (15 U.S.C. 3411(a) and (b), 3413(b)) may well encompass the authority to implement the NGPA by directing that gas that in fact falls into a deregulated as well as regulated category be treated as deregulated. Such an action, moreover, would seem consistent with the concerns underlying the congressional floor statements quoted by the court of appeals, as discussed in text *infra*.

[22] If this Court reverses the Tenth Circuit's decision overturning the Commission's ruling that qualification under Section 107(c)(5) (15 U.S.C. 3317(c)(5)) automatically entails qualification under Section 102 or 103 (15 U.S.C. 3312, 3313), it should be a rare case where gas that is qualified for regulated status has not also been qualified for a deregulated status for which it is eligible. Aside from Section 107(c)(5) gas, most of which the Commission's rule would automatically qualify for deregulated status, the only regulated gas that presents a significant potential problem of overlap with deregulated gas is stripper-well gas qualified under Section 108, 15 U.S.C. 3318. Almost all such gas that could qualify under Section 102 or 103, however, will already have been so qualified before the well's production diminished and the gas became eligible for Section 108 status.

the proper category (see App., *infra,* 19a (quoting statements)). Neither statement suggests that the classification task itself may not be simplified, in comformity with the NGPA, by requiring permanent deregulated treatment of gas that falls into both a regulated and a deregulated category.[23]

In any event, as even the court of appeals recognized (App., *infra,* 21a-22a n.15), specific statements in the legislative history on dual-qualified gas must be given little weight. Not only are the implications contradictory, but all statements were made on the factual assumption, which has turned out to be false for the past several years, that market prices would be higher than the price ceilings set in the statute. The 1978 Congress, because of that assumption, simply had no occasion to consider the possibility

[23] The court of appeals was faced with one narrow aspect of the issue of producer choice of qualification. The court overturned the Commission's ruling that "new tight formation" gas under Section 107(c)(5) (15 U.S.C. 3317(c)(5)), with a specified exception, is automatically qualified under Section 102 or 103 (15 U.S.C. 3312, 3313) and hence deregulated. The court of appeals reached that decision in passing in the course of explaining its broader dual-qualification holding. This separate holding would have a significant impact on gas pricing and should be reversed.

In addition to the Commission's general regulatory authority, which we think would support restrictions on producer category choice even in other contexts (see note 21, *supra*), there is clear authority for the Commission's ruling with respect to Section 107(c)(5) gas. As the court of appeals appears to have recognized on petitions for rehearing (App., *infra,* 30a), the Commission is expressly authorized to establish the criteria for qualification as Section 107(c)(5) gas. The court of appeals did not disagree with the Commission's decision to base Section 107(c)(5) qualification on the same facts as are required to qualify for Section 102 or 103 status. It merely rejected the automatic dual qualification. The Commission's authority, however, surely encompasses this effort to simplify the qualification and regulatory process by ruling that Section 107(c)(5) natural gas that demonstrably meets all of the Section 102 or 103 criteria, based soiely on the application for Section 107(c)(5) status, must be automatically so qualified.

that the deregulated price might not in fact be the price chosen by producers. There is, accordingly, no relevant evidence that Congress intended a principle of producer choice to override the command to deregulate.[24]

5. For all of the above reasons, the court of appeals' decision is erroneous: it creates a bizarre system of natural gas regulation (permitting repeated transfers of natural gas in and out of regulation) that is contrary to the language, structure, and overall aims of the NGPA. That conclusion is warranted independent of any deference to the Commission. But even if the statutory meaning is less than crystal clear, "a court may not substitute its own construction of a statutory provision for a reasonable interpretation by the * * * agency" entrusted with administration of the statute. *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.,* 467 U.S. 837, 844 (1984) (footnote omitted). See also *Clarke* v. *Securities Indus. Ass'n*, No. 85-971 (Jan. 14, 1987), slip op. 14-15; *Japan Whaling Ass'n* v. *American Cetacean Soc'y,* No. 85-954

[24] The court of appeals also cited (App., *infra,* 22a n.15) a statement in the Conference Report that "natural gas qualifying as gas produced from a natural gas stripper well [could be] sold subject to the provisions of sec. 108, rather than taking deregulated treatment as an existing intrastate contract" (H.R. Conf. Rep. 95-1752, *supra,* at 83). That statement, however, is not an explanation of Section 101(b)(5), but of a peculiar limitation on deregulation set by Section 121(e) (15 U.S.C. 3331(e)) for certain gas sold under intrastate contracts (NGPA § 105, 15 U.S.C. 3315). Moreover, the statement is in fact addressed to an overlap of two regulated categories (§ 108, 15 U.S.C. 3318, and § 105(b)(3), 15 U.S.C. 3315(b)(3)), not to the overlap of a regulated and a deregulated category. Indeed, the provision that the Conference Report statement explains, Section 121(e), supports the Commission's ruling here. In that provision, as in Section 101(b)(5), Congress addressed itself to dual-category gas; and Congress specifically provided that whenever the regulated category (§ 105(b)(3)) overlapped with a deregulated category (§§ 102, 103, 107(c)(1)-(4), 15 U.S.C. 3312, 3313, 3317(c)(1)-(4)), the deregulated category would be applicable.

(June 30, 1986), slip op. 11; *Young* v. *Community Nutrition Inst.*, No. 85-664 (June 17, 1986), slip op. 5-7. The Commission's interpretation is unquestionably reasonable[25] and should have been upheld by the court of appeals. *Mid-Louisiana Gas Co.*, 463 U.S. at 339.

6. The decision of the court of appeals should be reversed. This Court should not await development of a conflict among the circuits. So many gas producers were party to this challenge to the regulation that, for that reason alone, a conflict is unlikely to develop, at least in the near term. Meanwhile, the problem is of considerable practical importance. The Commission estimates that the 1985-1987 cost of the court of appeals' decision in higher natural-gas prices is approximately $300 million, and the costs continue to mount.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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[25] Indeed, as the Commission noted (see note 13, *supra*), several producers, including some of respondents here, argued in 1979 and 1980 that dual-qualified regulated-deregulated gas should be treated as deregulated irrespective of which price is higher.

* The Solicitor General is disqualified in this case.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Nos. 84-2756; 84-2759; 84-2760; 85-1172; 85-1250; 85-1254; 85-1257; 85-1443; and 85-1452.

MARTIN EXPLORATION MANAGEMENT COMPANY; COLORADO ENERGY CORPORATION; PHILLIPS PETROLEUM COMPANY; PHILLIPS OIL COMPANY; EXXON CORPORATION; SHELL OFF-SHORE, INC.; SHELL WESTERN E & P, INC.; INDEPENDENT OIL & GAS ASSOCIATION OF WEST VIRGINIA, AND AMOCO PRODUCTION COMPANY, PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT,

AND

ARCO OIL & GAS COMPANY; OHIO OIL AND GAS ASSOCIATION; INDEPENDENT OIL AND GAS ASSOCIATION OF WEST VIRGINIA; GULF OIL CORPORATION, SUCCESSOR TO CHEVRON, U.S.A., INC.; UNION OIL COMPANY OF CALIFORNIA; CHAMPLIN PETROLEUM COMPANY; PENNZOIL COMPANY, PENNZOIL OIL & GAS, INC., PENNZOIL PRODUCING COMPANY; PLACID OIL COMPANY; TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO, INC.; PACIFIC GAS & ELECTRIC COMPANY; AMOCO PRODUCTION COMPANY; TRANSOK, INC.; OKLAHOMA NATURAL GAS COMPANY, A DIVISION OF ONEOK, INC.; ASSOCIATED GAS DISTRIBUTORS; PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK; PACIFIC LIGHTING GAS SUPPLY COMPANY; SOUTHERN CALIFORNIA GAS COMPANY; CONSOLIDATED GAS TRANSMISSION CORPORATION; PANHANDLE EASTERN PIPE LINE COMPANY; CITIES SERVICE OIL AND GAS CORPORATION; GRACE PETROLEUM CORPORATION; VALERO TRANSMISSION COMPANY; BHP PETROLEUM COMPANY,

INC., SUCCESSOR TO MONSANTO OIL COMPANY; TEXAS EASTERN TRANSMISSION CORPORATION; TRANSWESTERN PIPELINE COMPANY; UNITED GAS PIPE LINE COMPANY; UNITED TEXAS TRANSMISSION COMPANY; AND TEXAS GAS TRANSMISSION CORPORATION, INTERVENORS.

PETITIONS FOR REVIEW OF AN ORDER OF THE FEDERAL ENERGY REGULATORY COMMISSION

Decided March 9, 1987

Before BARRETT and TACHA, Circuit Judges, and BROWN*, District Judge.

TACHA, Circuit Judge.

This appeal presents challenges by natural gas producers to the Federal Energy Regulatory Commission (FERC) orders interpreting the statutory mandate in § 121 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3331, to deregulate certain natural gas prices. For the reasons set forth in this opinion, we affirm the FERC orders in part and reverse in part.

I.

The NGPA "comprehensively and dramatically changed the method of pricing natural gas produced in the United States." *Public Serv. Comm'n., New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 320 (1983). The purposes of these changes "are rooted in the history of federal

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*The Honorable Wesley E. Brown, District Judge of the District of Kansas, sitting by designation.

natural gas regulation before 1978." *Id.* at 327. We therefore begin by examining the history of federal regulation of natural gas prices and the context in which the Ninety-Fifth Congress adopted the NGPA in 1978.

The first federal regulation of interstate sales of natural gas occurred with the passage of the Natural Gas Act of 1938 (NGA), Pub. L. No. 75-688, 52 Stat. 821 (codified as amended at 15 U.S.C. §§ 717-717w (1976)). "The NGA was enacted in response to reports suggesting that the monopoly power of interstate pipelines was harming consumer welfare." *Mid-Louisiana Gas Co.*, 463 U.S. at 327 (footnote omitted). State efforts to combat this problem had failed because they were found to be unconstitutional restrictions on interstate commerce. *E.g., Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924). The NGA authorized the Federal Power Commission (FPC)[1] to establish such price ceilings for the sale of interstate gas for resale as were "just and reasonable." 15 U.S.C. § 717c(a). The NGA did not regulate the price of gas sold in intrastate markets.

The FPC struggled to apply this scheme during the next several decades. By the 1970's, however, it became clear that the existing regulatory structure was inadequate. The federally regulated prices for interstate gas sales remained consistently below the unregulated prices for intrastate gas sales. Natural gas producers found it more profitable to commit more of their supplies to the intrastate market. At the same time, consumer demand for gas in the interstate market was artificially high because of the federally imposed ceiling prices. The result was a serious natural gas shortage in the interstate market. *See generally* Breyer and MacAvoy, *The Natural Gas Shortage and the Regulation of Natural Gas Producers*, 86 Harv. L. Rev. 941 (1973).

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[1] The FPC was succeeded by FERC pursuant to the Department of Energy Organization Act of 1977, 42 U.S.C. § 7101, 7134.

"The NGA and its regulatory history led to a single, overwhelming conclusion: under NGA regulations the domestic supply of natural gas could no longer meet consumer demands in the interstate market." Note, *Legislative History of the Natural Gas Policy Act: Title I*, 59 Tex. L. Rev. 101, 112 (1980) [hereinafter Note].

Congress repeatedly attempted to remedy this situation during the energy crisis of the 1970's. After several efforts to restructure the federal regulation of natural gas prices had failed, President Carter addressed the problem in his proposed Natural [*sic*] Energy Act in 1977. The President proposed an extension of price controls to the intrastate sale of natural gas and the establishment of a uniform and incentive-based pricing system for new natural gas. The House passed this proposal substantially unaltered. The Senate, however, was badly divided on the issue. Supporters of the House bill were opposed by supporters of the complete deregulation of natural gas prices. Proponents of deregulation believed that market forces would produce an equilibrium between supply and demand if the price of natural gas was not restricted. After a "pitched legislative battle," Note at 114, that included several filibusters, the Senate passed a bill that "would have maintained Natural Gas Act regulation for all gas sold or delivered in interstate commerce before January 1, 1977, and steadily cut back on Commission jurisdiction so that all natural gas sold after January 1, 1982, would have been completely deregulated." *Mid-Louisiana Gas Co.*, 463 U.S. at 331-32.

The Conference committee approved a compromise measure after months of deliberation. *See* H.R. Conf. Rep. No. 95-1752, 95th Cong., 2d Sess. [hereinafter Conf. Rep.], *reprinted in* 1978 U.S. Code Cong. & Admin. News 8983-9041. The committee bill did not adopt either the uniform regulation or the complete deregulation approach in their entirety; rather, the bill was the "careful reconciliation of two strong, but divergent, responses to the natural gas shortage." *Mid-Louisiana Gas. Co.*, 463 U.S. at 331. The conference bill was approved by both houses of Congress and signed into law by President Carter on November 9, 1978.

II.

The NGPA adopted new means to achieve the traditional purposes of the federal regulation of natural gas prices. "The aim of federal regulation remains to assure adequate supplies of natural gas at fair prices, but the NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand." *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 106 S. Ct. 709, 716 (1986). The resulting pricing system is an intricate balance of uniform price ceilings, incentive prices, and partial phased deregulation.

The statutory scheme established by the NGPA divides natural gas production into numerous categories that are distinguished by the date that production began from a well or the particular type of drilling involved. Gas in these categories can be broadly classified as "old" gas, "new" gas, or difficult to produce gas. "Old" gas is generally that produced from wells that had been operating before the passage of the NGPA. *See* NGPA § 104, 15 U.S.C. § 3314 (sales of natural gas dedicated to interstate commerce at the time of the passage of the NGPA); NGPA § 105, 15 U.S.C. § 3315 (sales of gas under intrastate contracts existing at the time of the passage of the NGPA); NGPA § 106, 15 U.S.C. § 3316 (sale of gas under rollover contracts). "New" gas is generally that produced from wells that began production after the passage of the NGPA. *See* NGPA § 102, 15 U.S.C. § 3312 (sale of gas from new Outer Continental Shelf leases, new onshore wells, or new onshore reservoirs); NGPA § 103, 15 U.S.C. § 3313 (sale

of gas from new onshore production wells). Several methods of production are specifically described in the statute as difficult to produce gas. *See* NGPA § 107, 15 U.S.C. § 3317 (sale of gas produced through particular high-cost methods);[2] NGPA § 108, 15 U.S.C. § 3318 (sale of stripper well natural gas).[3] The categories are not mutually exclusive: a particular sale may be "dually qualified" within a "new" or "old" gas category and also a difficult to produce category.

The NGPA established ceiling prices for each of these categories of natural gas production. In general, the lowest ceiling prices were for old gas, higher ceiling prices were established for new gas, and the highest ceiling prices were for difficult to produce gas. The purpose of creating different ceilings was to create an incentive to drill for new gas, particularly gas that is costly to produce. Conf. Rep. at 87. Such an incentive was unnecessary for gas that was already being produced at the time the NGPA was enacted. The ceiling prices were set by the statute and designed to increase periodically pursuant to statutory formulas. *See, e.g.*, 15 U.S.C. § 3312(b) (the ceiling price for

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[2] High-cost natural gas includes gas "produced under such other conditions as the Commission determines to present extraordinary risks or costs." 15 U.S.C. § 3317(c)(5). FERC has specified tight formation gas as being high-cost natural gas within the meaning of § 107(c)(5). 18 C.F.R. § 271.703 (1986). "A 'tight formation' is a sedimentary layer of rock cemented together in a manner that greatly hinders the flow of any gas through the rock. . . . To stimulate production from these formations, producers must use expensive enhanced recovery techniques." Regulations Covering High-Cost Natural Gas Produced from Tight Formations, 45 Fed. Reg. 56,034-35 (1980) (footnote omitted).

[3] A stripper well is a "well which producers such small volume of [gas] that the gross income therefrom provides only a small margin of profit or, in many cases, does not even cover actual cost of production." H. Williams & C. Meyers, *Manual of Oil and Gas Terms* 572 (4th ed. 1976).

new gas was $1.75 per million Btu's in April 1977 and was to increase at a set rate above the annual inflation factor).

The price that a producer can receive for the sale of natural gas is limited by these ceiling prices. The relevant category for a particular sale of natural gas is determined by a procedure set out in the statute. NGPA § 503, 15 U.S.C. § 3413. In essence, a producer must apply for a determination that gas comes within a particular category or categories. This determination is usually to be made by an authorized state agency subject to FERC and judicial review. *Id.* The ceiling price can then be determined once the producer has selected and received approval for the applicable category or categories. The ceiling price, however, is not necessarily the price that is charged. The NGPA explicitly provides that the contract price agreed to by the parties is binding as long as it is below the ceiling prices. NGPA § 101(b)(9), 15 U.S.C. § 3311(b)(9).

The ceiling prices established by the NGPA represent the result of the congressional compromise favorable to the advocates of uniform pricing. The deregulation proponents achieved a phased elimination of many, but not all, of those price ceilings. Section 121 eliminates the price ceilings for many categories of natural gas. Certain high-cost natural gas as defined in § 107(c)(1)-(4) was deregulated in 1979. 15 U.S.C. § 3331(b). New natural gas as defined in § 102, new onshore production wells as defined in § 103(c), and some intrastate gas were deregulated on January 1, 1985. 15 U.S.C. § 3331(a). Most natural gas produced from 5,000 feet or less is to be deregulated on July 1, 1987. 15 U.S.C. § 3331(c). *But see* 15 U.S.C. § 3331(d) (certain Alaska natural gas is excluded from deregulation). The NGPA does not speak of the elimination of the ceiling prices for any other categories of gas. In particular, old gas is not deregulated, but it was expected that old gas would account for a decreasing proportion of the sale of natural gas with the

passage of time. Pierce, *Natural Gas Regulation, Deregulation, and Contracts*, 68 Va. L. Rev. 63, 89 (1982). And, of particular importance in this case, the NGPA does not include § 107(c)(5) tight formation gas or § 108 stripper well gas on the face of the deregulation provisions of § 121.

III.

FERC announced a Notice of Proposed Rulemaking on September 13, 1984 to implement the deregulation provisions of § 121 of the NGPA. Deregulation and Other Pricing Changes on January 1, 1985, Under the Natural Gas Policy Act, 49 Fed. Reg. 36,399 (1984). Natural gas producers, pipelines, public utility commissions, consumer groups, and other interested parties filed extensive comments on the proposed rules. FERC then issued an order promulgating final rules interpreting § 121. 49 Fed. Reg. 46,874 (1984). After several parties sought a rehearing, FERC upheld that part of its earlier order relating to dual qualification gas but reversed that part of its earlier order concerning intrastate gas. 49 Fed. Reg. 50,637 (1984). FERC then declined to review its order on rehearing. 50 Fed. Reg. 7,333 (1985). Natural gas producers appeal from both of FERC's conclusions on rehearing. Jurisdiction is established in this court pursuant to the judicial review provisions of the NGPA. 15 U.S.C. § 3416.

We first note our standard of review of FERC interpretations of the NGPA. Our first inquiry is whether "Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984) (footnote omitted). *Accord Office of Consumers' Counsel, Ohio v. FERC*, 783 F.2d 206 (D.C. Cir. 1986) (upholding

as reasonable one FERC interpretation of the NGPA but reversing a second FERC interpretation because it conflicted with the plain meaning of the statute); *Nevada Power Co. v. Watt*, 711 F.2d 913, 920 (10th Cir. 1983). We will defer when an agency has chosen between alternative possible constructions of an ambiguous statute:

> If . . . the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

Chevron U.S.A., 467 U.S. at 843 (footnotes omitted). Where the plain words of the statute do not answer a particular question, the agency interpretation must be reasonable, but it need not be the only reasonable interpretation or the interpretation that the reviewing court would adopt. *See, e.g., Chemical Mfrs. Ass'n v. Natural Resources Defense Council, Inc.*, 470 U.S. 116, 125 (1985). A reviewing court will defer to an agency interpretation of an ambiguous statute unless the agency interpretation is contrary to the policies Congress sought to implement in enacting the statute. *See, e.g., Chevron U.S.A.*, 467 U.S. at 843 n.9; *Mid-Louisiana Gas Co.*, 463 U.S. at 342 (rejecting a FERC interpretation of the NGPA because it was contrary to the history, structure, and basic philosophy of the NGPA and would frustrate the policy Congress sought to implement).

IV.

FERC has interpreted the NGPA to provide that if a sale of natural gas has been determined to qualify for both a deregulated category and a regulated category, the

deregulated category will always determine the applicable price.[4] The producers challenge FERC's interpretation in this court. We reverse and remand because FERC's interpretation is contrary to the clear intent of Congress as expressed in the unambiguous language of the NGPA.

A.

The first section of the NGPA that we must consider is § 121, which provides that "the provisions of part A of this subchapter respecting the maximum lawful price for the first sale of each of the following categories of natural gas shall . . . cease to apply" on specified dates. 15 U.S.C. § 3331(a). FERC interprets the language "shall . . . cease to apply" to mean that if gas has been determined to be in one of the listed categories, there is no longer a ceiling price for such gas even if the gas has also been determined to be in a category that is not listed.[5] For example,

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[4] FERC promulgated the following regulation in support of its interpretation:

> § *270.208 Applicability of section 121.*
>
> First sales of natural gas that is deregulated natural gas as defined in [18 C.F.R.] § 272.103(a) is price deregulated and not subject to the maximum lawful prices of the NGPA, regardless of whether the gas also meets the criteria for some other category of gas subject to a maximum lawful price under Subtitle A of Title I of the NGPA.

18 C.F.R. § 270.208 (1986).

[5] FERC explained it[s] understanding of § 121 as follows:

> The statute clearly states that price controls for certain section 102(c), qualifying section 103(c) and section 105 gas "shall . . . cease to apply January 1, 1985." NGPA section 121 mandates deregulation for these categories of gas. The fact that some of this gas also qualifies for another gas category does not alter this Congressional mandate to deregulate.

49 Fed. Reg. at 50,638.

if a producer has received a determination that gas is both new gas within the meaning of § 102 and stripper well gas within the meaning of § 108, once the ceiling price for § 102 was abolished in 1985, there is no longer a ceiling price for such gas despite the fact that the ceiling price for § 108 was not eliminated by the express language of § 121.[6]

The producers, on the other hand, argue that § 121 was not intended to determine whether dual category gas is to receive a regulated price or a deregulated price. They interpret § 121 to deregulate only those categories of gas that are listed. The producers rely on the report of the Conference Committee, which states: "The conference agreement does not provide for deregulation of any natural gas production not specifically enumerated in [§ 121]." Conf. Rep. at 92. Additionally, the Supreme Court has said that "Sections 121 and 122 of the NGPA provide a mechanism for the ultimate decontrol of *a number of categories* of natural gas." *Mid-Louisiana*, 463 U.S. at 336 n.14 (emphasis added). According to the producers, then, the language "shall . . . cease to apply" in § 121(a) provides for the elimination of the ceiling price only for those categories that are listed. The producers disagree with FERC's conclusion that § 121 requires dual category gas to receive a deregulated price.

We conclude that § 121 is ambiguous. Therefore, in the absence of another provision in the statute, FERC's determination that dual category gas is to be considered deregulated would be a reasonable interpretation of the ambiguous language of § 121. But Congress anticipated precisely this question in § 101(b)(5).

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[6] Two types of gas that can be dually qualified within a regulated category and a deregulated category received particular attention from the commenters to the FERC order. First, tight formation gas under § 107(c)(5) can also be new gas under § 102 or § 103. Second, stripper well gas under § 108 can also be new gas under § 102 or § 103. *See* 49 Fed. Reg. at 46,877-78; 49 Fed. Reg. at 50,637 n.7.

B.

The NGPA established several "Rules of general application" for interpretation of the Act.[7] 15 U.S.C. § 3311(b). *See also* Conf. Rep. at 74 ("The conference agreement includes several rules of general application to be used in interpreting this Act."). One of these rules concerns "Sales qualifying under more than one provision" of the Act:

> If any natural gas qualifies under more than one provision of this subchapter providing for any maximum lawful price or for any exemption from such a price with respect to any first sale of such natural gas, the provision which could result in the highest price shall be applicable.

NGPA § 101(b)(5), 15 U.S.C. § 3311(b)(5). The plain language of this section addresses the very question that we are considering now: if gas has been determined to be dually qualified in a regulated category and a deregulated category, the category that could result in the highest price for the gas will apply.[8] FERC, however, has said that

[7] The FERC order relied on the general principle of statutory construction that "if there exists a conflict in the provisions of the same act, the last provision in point of arrangement must control." *Lodge 1858, Am. Fed'n of Gov't Employees v. Webb*, 580 F.2d 496, 510 (D.C. Cir.) (citing eighty-three cases), *cert. denied*, 439 U.S. 927 (1978). We do not perceive a conflict between § 121 and § 101(b)(5). Furthermore, a general principle of statutory construction cannot prevail over the "Rules of general application" specified in the NGPA itself.

[8] We are the first court to consider the operation of § 101(b)(5) of the NGPA. Several decisions, however, have mentioned § 101(b)(5) in dicta. *Mid-Louisiana*, 463 U.S. at 335 ("§ 101(b)(5) of the Act specifies that if a volume of gas fits into more than one category, 'the provision which could result in the highest price shall be applicable' ") (citation omitted); *Amoco Prod. Co. v. Western Slope Gas Co.*, 754 F.2d 303, 305 (10th Cir. 1985) ("The NGPA further provides that,

§ 101(b)(5) is "helpful, but not dispositive" of this question.[9] 49 Fed. Reg. at 46,879. FERC has concluded that § 101(b)(5) does not apply to gas that has been determined to be in a deregulated category. This conclusion, however, is based on a strained construction of the unambiguous language of § 101(b)(5) and a misunderstanding of the purposes Congress sought to achieve in enacting the NGPA.

1.

Section 101(b)(5) applies to those categories of gas "providing for any maximum lawful price or for any *exemption* from such a price." Several commenters on the regula-

where gas falls within the scope of multiple categories prescribing different ceiling prices, the highest ceiling price is applicable."); *Columbia Gas Dev. Corp. v. FERC*, 651 F.2d 1146, 1156-57 (5th Cir. 1981) ("If the [§ 104] gas qualifies for incentive pricing under section 102(d), 107(c)(5), or 108, under the rule of section 101(b)(5) the highest ceiling price becomes the applicable ceiling price."); *Oklahoma v. FERC*, 494 F. Supp. 636, 645 (W.D. Okla. 1980) ("Gas qualifying in more than one category is entitled to the highest price . . . ."), *aff'd*, 661 F.2d 832 (10th Cir. 1981), *cert. denied*, 457 U.S. 1105 (1982).

[9] FERC has considered two arguments that § 121 prevails against § 101(b)(5). It is first suggested that because § 121 includes particular exceptions to its provisions, *see* 15 U.S.C. § 3331(d)-(e), an exception for dually qualified gas should not be inferred. This argument, of course, assumes its conclusion: that § 121 deregulates gas that has been dually qualified. We have already concluded that § 121 does not address this situation. Second, several commenters asserted that § 101(b)(5) is a "provision of subtitle A" that "shall . . . cease to apply" on January 1, 1985, according to § 121. This argument proves too much. Section 101(b)(5) is one of the "Rules of general application" for the NGPA. 15 U.S.C. § 3311(b). Some of the other "Rules of general application" define certain terms used in the Act and make it clear that the Act does not nullify or supersede contract prices set below the applicable ceiling price. 15 U.S.C. § 3311(b)(1), (2), (9). We cannot seriously consider the suggestion that these definitions and rules no longer apply after January 1, 1985.

tion proposed by FERC argued that categories for which no price ceiling now exists—*i.e.*, deregulated gas—are not categories "providing . . . for any exemption from such a price." 15 U.S.C. § 3311(b)(5). FERC did not explicitly rely on this interpretation of "exemption," but it did recognize that "there may be some merit to these arguments." 49 Fed. Reg. at 50,638.

FERC has suggested that the reference to "any exemption from such a price" refers not to deregulated gas, but rather to the authority of FERC to provide for special ceiling prices in particular situations. 49 Fed. Reg. at 36,401.[10] We have no doubt that the reference to "exemption" in § 101(b)(5) can refer to those instances in which FERC can exercise its statutory authority to set a different ceiling price when special circumstances are present. It does not follow, however, that "exemption" does not refer to deregulated categories of gas as well. The plain meaning of "exemption from such a price" includes those categories for which a price ceiling no longer exists. This interpretation of "exemption" is also consistent with the meaning of "exemption" in § 101(b)(9) of the NGPA. Section 101(b)(9) provides:

> In the case of . . . any price which is established under any contract for the first sale of natural gas which is *exempted* under part B of this subchapter from the application of a maximum lawful price under this subchapter, such maximum lawful price, or such *exemption* from such a maximum lawful price, shall not supersede or nullify the effectiveness of the price established under such contract.

15 U.S.C. § 3311(b)(9) (emphasis added). FERC has interpreted this section to set forth "the effect of the contract,

[10] FERC has the authority to raise the ceiling price for several categories of gas to a price that is "just and reasonable." 15 U.S.C. § 3314(b)(2); 15 U.S.C. § 3316(c); 15 U.S.C. § 3319(b)(2).

regardless of the statutorily imposed maximum lawful ceiling prices or *exemptions from ceiling prices, i.e., deregulated prices.*" 49 Fed. Reg. at 46,879 (emphasis added). Similarly, the Fifth Circuit has referred to "exemption" in § 101(b)(9) to mean deregulated prices. *Pennzoil Co. v. FERC*, 645 F.2d 360, 374 (5th Cir. 1981), *cert. denied,* 454 U.S. 1142 (1982). Recognizing that a word found in two sections of a statute is intended to have the same meaning in each section, *Sorenson v. Secretary of the Treasury*, 106 S. Ct. 1600, 1606 (1986) (citations omitted), we hold that the reference to "any exemption from such a price" in § 101(b)(5) includes categories of gas for which there is no longer a ceiling price. Accordingly, § 101(b)(5) anticipates the question of which category shall apply when gas has been determined to qualify both for a regulated category and a deregulated category.

2.

FERC construes § 101(b)(5) to provide the same answer to this question in every case: the deregulated category will always apply. The key to FERC's argument is the meaning of the word "could" in § 101(b)(5). Section 101(b)(5) provides that "the provision which *could* result in the highest price shall be applicable." FERC's interpretation of § 101(b)(5) relies on the obvious truth that the price of deregulated natural gas in an open market "could" theoretically reach infinity. No one contests this observation. FERC then argues that because the price of deregulated gas could theoretically rise indefinitely, it therefore "could" always be greater than the price of regulated gas. This is also true. But FERC has failed to construe "could" as broadly in considering regulated categories of gas as it has in considering deregulated categories of gas. FERC has the authority to raise the ceiling price for regulated gas in several categories to a price that is "just and reasonable." *See* 15 U.S.C. § 3314(b)(2);

15 U.S.C. § 3316(c); 15 U.S.C. § 3319(b)(2). Additionally, the ceiling prices for all categories of gas rise steadily under the statute. *See, e.g.,* 15 U.S.C. § 3312(b)(2) (describing the formula for the increase of the ceiling price of new gas). The price of regulated gas is therefore certain to rise, and is capable of reaching an indefinite "just and reasonable" rate. Thus, the price of deregulated gas in an abstract situation "could" be higher than the price of regulated gas, but the price of regulated gas "could" be higher than the price of deregulated gas. Such an understanding of "could"—one that considers only the theoretical possibilities—renders § 101(b)(5) meaningless. If either price "could" be higher than the other price, the explicit command of § 101(b)(5) that "the provision which could result in the highest price shall be applicable" serves no purpose. We will not interpret a statute in such a way that a particular provision has no meaning. *Nevada Power Co.,* 711 F.2d at 920 (citations omitted).

"Could" makes sense in § 101(b)(5) only in the context of how gas sales actually occur. The NGPA focuses on sales at a particular point in time. *See, e.g.,* 15 U.S.C. § 3315(a) (the ceiling price "shall apply to any first sale of natural gas delivered during any month"). Section 101(b)(5) therefore requires a comparison of the applicable price for each category at a particular moment. In most instances the contract between the producer and the pipeline specifies the price which is to apply to categories that have been regulated and categories that have been deregulated.[11] The contractual provision that "could"

[11] Natural gas producers and pipelines have anticipated the deregulation of natural gas. Accordingly, "[m]any contracts contain two clauses—one which sets the price if gas is regulated and one which is implemented if gas is deregulated." 49 Fed. Reg. at 46,878. Section 101(b)(5) provides that if gas is dually qualified in a regulated category and a deregulated category, the contractual price for regulated gas in the regulated category is to be compared with the contractual price for deregulated gas in the deregulated category. The higher of these two prices will determine the applicable category for a particular month.

Many gas contracts establish a specific price for deregulated gas or provide that the deregulated price is determined by the price of other gas sales. *See generally Materials on Oil & Gas Contracts* 10-11, 481-82 (J. Lowe ed. 1985). In each of these instances the contract provides a specific price for deregulated gas that can be compared with the price for regulated gas.

However, "many gas sales contracts contain a clause which requires the parties to renegotiate the sales contract if deregulation occurs." 49 Fed. Reg. at 46,879. Such a provision results in a "Catch-22" situation because of § 101(b)(5): the deregulated category will apply only if the renegotiated price is greater than the regulated price, but the contractual provision calling for renegotiation does not take effect until the gas has been deregulated. Furthermore, the price of gas will probably never vary from the regulated price if the deregulated price is to be set by renegotiation. Gas will be sold at the regulated price unless the producer and the pipeline agree to a different price. A producer is unlikely to renegotiate for a price below the regulated price; a pipeline is unlikely to renegotiate for a price above the regulated price. The regulated price, then, will always prevail.

The effect of a renegotiation clause might suggest that FERC is correct: § 101(b)(5) was not meant to apply to categories of gas that have been deregulated. As we have shown, however, the plain language of § 101(b)(5) refers to categories of gas that are exempt from ceiling prices—deregulated categories. And as we will show, FERC's intepretation of § 101(b)(5) would deny the statutory right of a producer to qualify gas in the category or categories of his or her choice. For these reasons, we hold that § 101(b)(5) was intended to apply to categories of gas that have been deregulated. We recognize that the effect of a renegotiation clause is to create an anomaly in the operation of the NGPA in certain circumstances, but we defer to Congress for the appropriate resolution of this difficulty. *See Board of Governors of the Fed. Reserve Sys. v. Dimension Fin. Corp.,* 106 S.Ct. 681, 689 (1986).

result in the highest price in a particular month will establish the applicable category under § 101(b)(5).

3.

Much of the concern voiced by the intervenor pipelines and FERC suggests that § 101(b)(5) was not intended to allow producers an ongoing choice as to whether gas sales are to be regulated or deregulated. In a sense, this is correct, for § 101(b)(5) does not speak in terms of a choice or an election. Instead, § 101(b)(5) provides that whichever category could produce a higher price *shall* apply. But producers are clearly presented with a choice as to which category or categories for which they seek to qualify particular gas. This is the election that the statute allows and which FERC would deny.

FERC has concluded that "a determination that gas qualifies as new tight-formation gas is implicitly a determination that the gas meets the qualifications for either section 102(c) or 103." 49 Fed. Reg. at 46,880; *see also* 49 Fed. Reg. at 50,639. FERC recognizes that such a dual qualification was unlikely to have been explicit at the time the determination was made. Nevertheless, a producer who decided to qualify gas *only* as tight formation gas under § 107(c)(5), a category that is not listed for deregulation in § 121, would be held by FERC to have also obtained a determination that the gas is new gas under § 102 or § 103—categories which have now been deregulated. There is no support for such automatic determinations in the NGPA. Although the showing required for a qualification under § 107(c)(5) would usually support a qualification under § 102 or § 103,[12] Congress did not provide that one qualification would automatically

[12] The information required to receive a determination that gas qualifies as new tight formation gas includes the information required to qualify gas as new gas under § 102 or a new onshore production well under § 103. 18 C.F.R. § 274.205(e)(1)(i) (1986). Recompletion tight formation gas, however, cannot necessarily be qualified under any other category. 49 Fed. Reg. at 46,880 n.18.

result in a second qualification. Instead, Congress intended that a producer select the category or categories for which he or she desires to qualify particular gas. In describing the operation of § 101(b)(5), Representative Dingell stated:

> Of course this does not impose upon either the FERC or any state agency an affirmative obligation to identify which of several potential classifications should apply. It is up to the producer to apply for whatever designation he determines is most likely to be of greatest benefit to him (in most cases that will be the designation which also yields the highest price).

124 Cong. Rec. 38,363-64 (1978). Similarly, Senator Jackson said that § 101(b)(5) "stands for the proposition that a producer may claim or apply for the highest price to which he is entitled. It does not imply an administrative duty to compel a State or Federal agency to search through the various price classifications under the act and find the permissible price." 124 Cong. Rec. 29,109 (1978).

FERC's order thus rests on the erroneous assumption that gas can be determined to qualify for a particular category without going through the specific determination procedure set forth in § 503. For this reason, FERC's intepretation cannot be upheld.[13]

[13] In addition to implicitly determining that gas qualifies for a category for which a producer has not applied, FERC would limit the period during which a producer could obtain a determination. According to FERC, a producer must apply for a determination that gas qualifies for a particular category before deregulation goes into effect. Brief of Respondent at 30. Section 101(b)(5) then operates to allow a producer to qualify gas in two categories and obtain the higher ceiling price until one of the categories has been deregulated. Upon deregulation, however, the decision of the producer to obtain a determination that the gas qualifies for a category that has now been deregulated means that the gas is now deregulated and no ceiling price applies.

We do not know why FERC believes there is a particular date after which a producer cannot obtain a determination that gas qualifies for

C.

Although we have concluded that the clear language of the NGPA requires us to reject FERC's treatment of dual category gas, we recognize that FERC suggests that the goals of the NGPA support its position. FERC has defended its interpretation as "consistent with the overall scheme envisioned by Congress when it enacted the NGPA—to provide incentive prices to encourage exploration and development of new reserves in the short-term, and to gradually substitute market forces for regulated prices by phasing in deregulation in 1985 and 1987." 49 Fed. Reg. at 36,401; 49 Fed. Reg. at 46, 878. FERC has properly recognized the statutory "goal of increasing energy supplies." 49 Fed. Reg. at 50,638. But FERC has concluded, "It is our belief that the statutory intent to deregulate takes precedence over the statute's increased supply objective." 49 Fed. Reg. at 46,878.

FERC has confused the ultimate purpose of the statute—"to assure adequate supplies of natural gas at fair prices," *Transcontinental Gas Pipe Line Corp.*, 106 S. Ct. at 716—with one of several means chosen to accomplish that purpose—phased deregulation. FERC is correct that "phased deregulation was one of the primary methods utilized by Congress to increase energy supplies." 49 Fed. Reg. at 50,638 (footnote omitted). But the NGPA was the "careful reconciliation of two strong, but divergent, responses to the natural gas shortage." *Mid-Louisiana*,

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a particular category. Nothing in the statute requires such a result. Indeed, FERC still requires producers who wish to sell gas that could be qualifed only under a category that has been deregulated to obtain a determination that the gas qualifies for that category. 49 Fed. Reg. at 46,875-76. It is thus difficult for FERC to maintain that a producer must qualify gas in a particular category before the date deregulation takes effect.

463 U.S. at 331.[14] Incentive prices for difficult to produce gas are another means by which Congress sought to increase energy supplies.[15] We do not agree with FERC that

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[14] Congress may be unanimous in its intent to stamp out some vague social or economic evil; however, because its Members may differ sharply on the means for effectuating that intent, the final language of the legislation may reflect hard fought compromises. Invocation of the "plain purpose" of legislation at the expense of the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of congressional intent.

Board of Governors of the Fed. Reserve Sys. v. Dimension Fin. Corp., 106 S. Ct. 681, 689 (1986).

[15] "The new statutory rates are intended to provide investors with adequate incentives to develop new sources of supply." *Mid-Louisiana*, 463 U.S. at 334. In particular, "Section 108 is a special incentive rate for stripper wells, that is, marginal production. . . . The § 108 rate . . . is the highest regulated rate provided for by the NGPA." *Pennzoil Co.*, 645 F.2d at 380 n. 39.

The Congressional debate over the NGPA provides somewhat contradictory indications as to whether stripper well gas was to be considered deregulated after new gas was deregulated. Representative Dingell's statement that dual qualification "would permit the producer to obtain stripper well pricing under section 108 prior to January 1, 1985, and deregulation as new gas thereafter" could support either interpretation of § 101(b)(5) in light of his assumption that the deregulated price of natural gas would be higher than the regulated price by 1985. 124 Cong. Rec. 38,364 (1978). FERC places greater weight on the statement of Senator Bartlett:

> [I]n informal discussions on the floor it has been asserted that stripper wells are deregulated. This is true only to the extent that such wells are otherwise new wells and would be deregulated anyway. Their character as stripper wells, as shown under section 121, does not get them deregulated in any way. And since the vast majority of all stripper wells are wells now in existence, there would be very little deregulation caused by that section.

124 Cong. Rec. 31,387 (1978). At another point in the debate, however, Senator Bartlett said, "This bill will keep under Federal controls *forever* the following categories of natural gas: all flowing interstate gas; all offshore gas produced from present leases, including

the incentive prices are necessarily short-term.[16] These prices are never removed by the express language of § 121, so gas that qualifies only for an incentive price category will unquestionably remain regulated. Deregulation is both phased *and* partial. *See* A. Tussing & C. Barlow, *The Natural Gas Industry* 116 (1984) (noting that old gas is never deregulated under the NGPA). By misinterpreting the NGPA to be exclusively a deregulation statute, FERC has overlooked incentive prices and other provisions that sought to address the natural gas shortage in a different way. We will not strain the plain meaning of § 101(b)(5) in order to serve a goal of deregulation that is itself only one of several means adopted to achieve the purposes of the NGPA.

Congress enacted the NGPA expecting that natural gas prices would rise steadily in future years. *See, e.g.*, 124 Cong. Rec. 38,361 (1978) (statement of Rep. Dingell); 124 Cong. Rec. 31,819 (statement of Sen. Metzenbaum). That prices have actually dropped precipitously accounts for

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the new discoveries; all intrastate gas under contract at a price below $1 per thousand cubic feet; and *stripper well natural gas*." 124 Cong. Rec. 29,379 (1978) (emphasis added). Furthermore, the Conference Report suggested that "natural gas qualifying as gas produced from a natural gas stripper well [could be] sold subject to the provisions of sec. 108, rather than taking deregulated treatment as an existing intrastate contract." Conf. Rep. at 83. We give greatest weight to the position expressed in the Conference Report.

[16] In *Transcontinental Pipe Line Gas Corp.*, 106 S. Ct. at 716-17, the Court referred to "Congress' determination, that the supply, the demand, and the price of high-cost gas to be determined by market forces." The type of high-cost gas at issue in that case was § 107(c)(1) gas "produced from any well [with] a completion location which is located at a depth of more than 15,000 feet." 15 U.S.C. § 3317(c)(1). The ceiling price for § 107(c)(1) gas was eliminated by the express provision of § 121(b), thereby demonstrating Congress' intent that market forces should determine the price for such gas. In contrast, the incentive prices for, *inter alia*, § 107(c)(5) and § 108 gas are never eliminated by § 121.

the anomalous situation we now see: producers seek the regulated ceiling price rather than the deregulated market price.[17] Because § 101(b)(5) provides that the category which could result in the highest price applies, gas that has been qualified in both a regulated category and a deregulated category will now be sold at the regulated price until the market price rises above the ceiling price. Therefore, § 101(b)(5) can have the unanticipated effect of operating as a price floor for producers. Congress did not expect this result, for Congress did not expect that natural gas prices would fall. Changes in economic conditions, however, do not provide the courts with a license to change the express terms of a statute. *See BankAmerica Corp. v. United States*, 462 U.S. 122, 133 (1983).

We observe that the Supreme Court was confronted with a similar problem earlier this year. In *Board of Governors of the Fed. Reserve Sys. v. Dimension Fin. Corp.*, 106 S. Ct. 681 (1986), the Court considered a definition of "bank" selected by the Federal Reserve Board because it was thought to be consistent with the broad purposes of the Bank Company Holding Act, 12 U.S.C. §§ 1841-1850. The Court referred to a similar situation that it had considered previously:

> The process of effectuating Congressional intent at times may yield anomalies. In *TVA v. Hill*, 437 U.S. 153, 98 S.Ct. 2279, 57 L.Ed.2d 117 (1978) [holding that the express language of the Endangered Species Act did not admit of an exception when an almost completed multi-million dollar dam project threatened

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[17] Natural gas producers advanced the interpretation adopted by FERC in this case when market conditions would have produced a higher price for deregulated gas. *See* Interim Rule Covering High-Cost Natural Gas Produced from Tight Formations, 45 Fed. Reg. 13,422 (1980).

> to render the three-inch snail darter extinct], for example, we were confronted with the explicit language of a statute that in application produced a curious result. Noting that nothing prohibited Congress from passing unwise legislation, we upheld the enforcement of the statute as Congress had written it. Congress swiftly granted relief to the petitioner in *Hill*; but did so in a fashion that could not have been tailored by the courts. See Pub.L. 95-632, § 5, 92 Stat. 3760.

Id. at 689 n.7. The Court in *Dimension* held that the definition proposed by the Federal Reserve Board conflicted with the plain language of the Act, concluding that "[t]he statute may be imperfect, but the Board has no power to correct flaws that it perceives in the statute it is empowered to administer." *Id.* at 689.

Congress is capable of modifying the operation of § 101(b)(5) if it desires to do so. This court, however, will not undertake that task. Our role is simply to give effect to the words Congress has chosen. We therefore hold that FERC acted contrary to the intent of Congress as evidenced in the unambiguous language of § 101(b)(5). We reverse and remand for further proceedings consistent with this opinion.

V.

The second FERC order that we review concerns the deregulation of intrastate gas. A trio of statutory provisions—§§ 121(a)(3), 121(e), and 105(b)(3)(A)—determine the status of intrastate gas that is sold pursuant to a contract that existed at the time of the enactment of the NGPA. 15 U.S.C. § 3331(a)(3); 15 U.S.C. § 3331(e); 15 U.S.C. § 3315(b)(3)(A). FERC adopted a different construction of these provisions on rehearing than it had in its original order. *Compare* 49 Fed. Reg. at 46,880 (final rule)

with 49 Fed. Reg. at 50,640-41 (order on reh'g). Only Shell appeals from the order on rehearing. We affirm.

Section 121(a)(3) provides for the deregulation of:

> Natural gas sold under an existing contract, any successor to an existing contract, or any rollover contract if—
>
> (A) such natural gas was not committed or dedicated to interstate commerce on November 8, 1978; and
>
> (B) the price paid for the last deliveries of such natural gas occurring on December 31, 1984, or, if no deliveries occurred on such date, the price would have been paid had deliveries occurred on such date is higher than $1.00 per million Btu's.

15 U.S.C. § 3331(a)(3). In essence, § 121(a)(3) deregulates intrastate gas that is sold under a contract that set a price in excess of $1.00 on December 31, 1984.

Once such gas has been deregulated, it can become subject to a "special rule" limiting the price that can be obtained pursuant to an indefinite price escalator clause.[18] Conf. Rep. at 83. Congress was concerned that "following deregulation, the operation of indefinite price escalator clauses . . . could operate to increase rapidly intrastate gas prices following deregulation." 124 Cong. Rec. 38,365 (1978) (statement of Rep. Dingell). Therefore, sections 121(e) and 105(b)(3)(A) were included to avoid rapid price increases by restricting the operation of indefinite price

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[18] An "indefinite price escalator clause" is a contractual provision:

> (i) which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference to other prices for natural gas, for crude oil, or for refined petroleum products; or
>
> (ii) which allows for the establishment or adjustment of the price of natural gas delivered under such contract by negotiation between the parties.

15 U.S.C. § 3315(b)(3)(B).

escalator clauses. Section 121(e) provides that § 105(b)(3)(A) applies to natural gas that has been deregulated by § 121(a)(3) and "which is sold under any existing contract or successor to an existing contract at a price established under an indefinite price escalator clause." 15 U.S.C. § 3331(e). Section 105(b)(3)(A), in turn, provides:

> Effective January 1985, and each month thereafter, in the case of any first sale of natural gas, which is sold at a price established under any indefinite price escalator clause of any existing contract or successor to an existing contract and for which the contract price on December 31, 1984, is higher than $1.00 per million Btu's, the maximum lawful price . . . shall be [established pursuant to a formula set forth in this section].

15 U.S.C. § 3315(b)(3)(A). FERC and Shell agree that the special rule embodied in § 105(b)(3)(A) operates to limit only those price increases caused by an indefinite price escalator clause. The parties disagree about the category of gas to which the special rule applies.

FERC has concluded that "the section 121(e) and section 105(b)(3)(A) limitation applies to any indefinite price escalator clause in an existing or successor intrastate contract that is, or would have been in excess of $1.00 per MMBtu on December 31, 1984." 49 Fed. Reg. at 50,641. Shell argues that the limitation applies to intrastate contracts only "if they were above $1.00 on December 31, 1984 *solely by reason of indefinite price escalator clauses.*" Supplemental Initial Brief of Shell Offshore Inc. and Shell Western E&P Inc. at 12 (emphasis original). The crucial difference is this: the FERC interpretation does not focus on how the price was established on December 31, 1984, while Shell would limit the application of the special rule

to those circumstances in which the indefinite price escalator clause established the price on December 31, 1984.

We hold that FERC has adopted a reasonable interpretation of the provisions of the NGPA that deregulate intrastate natural gas sales. The plain language of § 105(b)(3)(A) does not demand the interpretation advanced by Shell. Sections 105(b)(3)(A) and 121(e) impose a special rule limiting the price that can now be established by an indefinite price escalator clause. Those sections, however, do not contain the additional requirement that the December 31, 1984 price be established by an indefinite price escalator clause. The Conference Report makes it clear that *how* the December 31, 1984 price exceeded $1.00 is not relevant:

> This special rule limits the operation of indefinite price escalator clauses in existing intrastate contracts for which the contract price on December 31, 1984 is higher than $1.00 per MMBtu's. . . . This limitation applies to natural gas which is deregulated solely as a result of qualifying as an existing contract or a successor to an existing contract in excess of $1.00 per million Btu's on or before December 31, 1984.

Conf. Rep. at 83. Nor does the agreement reached by the conferees suggest that how the price was established on December 31, 1984 is important:

> [I]f the price of natural gas under the contract was greater than $1.00/MM Btu's on December 31, 1984, the price thereafter charged for natural gas . . . subject to such contract may not exceed [the ceiling price imposed by the special rule] due to the operation of any indefinite price escalator clause in such contract.

Staff of House Comm. on Interstate and Foreign Commerce & Staff of Senate Comm. on Energy and Natural Resources, 95th Cong., 2d Sess., *Natual Gas Pricing*

Agreement Adopted by the Conferees on H.R. 5289 18-19 (Comm. Print. 1978).

Shell has suggested that the reference to $1.00 per million Btu's in § 105(b)(3)(A) is superfluous under FERC's construction of the statute. Section 121(a)(3) deregulates only that natural gas which exceeds the $1.00 threshold. The additional reference to the threshold in § 105(b)(3)(A) is necessary to limit the application of the special rule to gas that was priced above $1.00 on December 31, 1984. Without such a reference in § 105(b)(3)(A), the special rule would also apply to natural gas that was sold at a price below $1.00 on December 31, 1984 and therefore has not been deregulated by § 121(a)(3). The $1.00 threshold thus operates to distinguish between two schemes of regulation. Gas priced below $1.00 on December 31, 1984 remains subject to the ceiling price imposed by § 105(b). Gas priced above $1.00 on December 31, 1984 is subject to a slightly different ceiling on the price established by an indefinite price escalator clause. Accordingly, FERC's interpretation has properly given effect to all parts of the statute.

VI.

FERC's conclusion that natural gas that has been qualified both in a regulated category and a deregulated category is always to be considered deregulated is contrary to the express language of § 101(b)(5) of the NGPA. Accordingly, we reverse and remand that part of the order. FERC's interpretation of the provisions governing the deregulation of intrastate gas is reasonable. We therefore affirm that part of the order.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

MARCH TERM, 1987

Nos. 84-2756, 84-2759, 84-2760, 85-1172, 85-1250, 85-1254, 85-1257, 85-1443, and 85-1452.

MARTIN EXPLORATION MANAGEMENT COMPANY, COLORADO ENERGY CORPORATION, PHILLIPS PETROLEUM COMPANY, PHILLIPS OIL COMPANY, EXXON CORPORATION, SHELL OFF-SHORE, INC., SHELL WESTERN E & P, INC., INDEPENDENT OIL & GAS ASSOCIATION OF WEST VIRGINIA, AND AMOCO PRODUCTION COMPANY, PETITIONERS,

vs.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT,

ARCO OIL & GAS COMPANY, OHIO OIL AND GAS ASSOCIATION, INDEPENDENT OIL AND GAS ASSOCIATION OF WEST VIRGINIA, GULF OIL CORPORATION, SUCCESSOR TO CHEVRON, U.S.A., INC., UNION OIL COMPANY OF CALIFORNIA, CHAMPLIN PETROLEUM COMPANY, PENNZOIL COMPANY, PENNZOIL OIL & GAS, INC., PENNZOIL PRODUCING COMPANY, PLACID OIL COMPANY, TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO, PACIFIC GAS & ELECTRIC COMPANY, AMOCO PRODUCTION COMPANY, TRANSOK, INC., OKLAHOMA NATURAL GAS COMPANY, A DIVISION OF ONEOK, INC., ASSOCIATED GAS DISTRIBUTORS, PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PACIFIC LIGHTING GAS SUPPLY COMPANY, SOUTHERN CALIFORNIA GAS COMPANY, CONSOLIDATED GAS TRANSMISSION CORPORATION, PANHANDLE EASTERN PIPE LINE COMPANY, CITIES SERVICE OIL AND GAS CORPORATION, GRACE PETROLEUM CORPORATION, VALERO TRANSMISSION COMPANY, BHP PETROLEUM COMPANY,

INC., SUCCESSOR TO MONSANTO OIL COMPANY, TEXAS EASTERN TRANSMISSION CORPORATION, TRANSWESTERN PIPELINE COMPANY, UNITED GAS PIPE LINE COMPANY, UNITED TEXAS TRANSMISSION COMPANY, AND TEXAS GAS TRANSMISSION CORPORATION, INTERVENORS.

[Filed May 1, 1987]

Before Honorable James E. Barret, Honorable Monroe G. McKay, Honorable James K. Logan, Honorable Stephanie K. Seymour, Honorable John P. Moore, Honorable Stephen H. Anderson, Honorable Deanell R. Tacha, and Honorable Bobby R. Baldock, Circuit Judges.

On consideration of the petitions for rehearing, the panel that rendered the decision modifies the original opinion as follows:

1. The first line on page 22 of the slip opinion [page 17a, *supra*] is modified to read ". . . the highest price at a particular moment will establish the . . . ."
2. Add the following paragraph to footnote 12 on page 23 [page 18a, *supra*]:

   The specification of what types of gas are "produced under such other conditions as [FERC] determines to present extraordinary risks or costs" and thus qualify under § 107(c)(5) is obviously left to the discretion of FERC. Our decision in this case does not interfere with FERC's continuing authority to modify the criteria that establish which types of gas qualify under § 107(c)(5).

3. The first sentence of the second paragraph on page 28 [page 23a, *supra*] should read:

   "We observe that the Supreme Court was confronted with a similar problem last term."

Upon modifications of the opinion, the petitions for rehearing are denied by the panel that rendered the opinion.

The petitions for rehearing having been denied by the panel to whom the cases were argued and submitted, and no member of the panel or judge in regular active service on the court having requested a poll on rehearing en banc, Fed. R. App. P. 35, the suggestions for rehearing en banc are denied.

Chief Judge Holloway took no part in consideration of the suggestion for rehearing en banc.

ROBERT L. HOECKER
Clerk

By: /s/ PATRICK FISHER
Patrick Fisher
Chief Deputy Clerk

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

MARCH TERM, 1987

Nos. 84-2756; 84-2759; 84-2760; 85-1172; 85-1250;
85-1254; 85-1257; 85-1443; 85-1452;
85-1255 and 12-1256

MARTIN EXPLORATION MANAGEMENT COMPANY; COLORADO ENERGY CORPORATION; PHILLIPS PETROLEUM COMPANY; PHILLIPS OIL COMPANY; EXXON CORPORATION; SHELL OFF-SHORE, INC.; SHELL WESTERN E & P, INC.; INDEPENDENT OIL & GAS ASSOCIATION OF WEST VIRGINIA, AND AMOCO PRODUCTION COMPANY, PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT,

AND

ARCO OIL & GAS COMPANY; OHIO OIL AND GAS ASSOCIATION; INDEPENDENT OIL AND GAS ASSOCIATION OF WEST VIRGINIA; GULF OIL CORPORATION, SUCCESSOR TO CHEVRON, U.S.A., INC.; UNION OIL COMPANY OF CALIFORNIA; CHAMPLIN PETROLEUM COMPANY; PENNZOIL COMPANY, PENNZOIL OIL & GAS, INC., PENNZOIL PRODUCING COMPANY; PLACID OIL COMPANY; TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO, INC.; PACIFIC GAS & ELECTRIC COMPANY; AMOCO PRODUCTION COMPANY; TRANSOK, INC.; OKLAHOMA NATURAL GAS COMPANY, A DIVISION OF ONEOK, INC.; ASSOCIATED GAS DISTRIBUTORS; PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK; PACIFIC LIGHTING GAS SUPPLY COMPANY; SOUTHERN CALIFORNIA GAS COMPANY; CONSOLIDATED GAS TRANSMISSION CORPORATION; PANHANDLE EASTERN PIPE LINE COMPANY; CITIES SERVICE OIL AND GAS CORPORATION; GRACE PETROLEUM CORPORATION; VALERO TRANSMISSION COMPANY; BHP PETROLEUM COMPANY,

INC., SUCCESSOR TO MONSANTO OIL COMPANY; TEXAS EASTERN TRANSMISSION CORPORATION; TRANSWESTERN PIPELINE COMPANY; UNITED GAS PIPE LINE COMPANY; UNITED TEXAS TRANSMISSION COMPANY; AND TEXAS GAS TRANSMISSION CORPORATION, INTERVENORS.

[Entered March 9, 1987]

Before the Honorable James E. Barret, Honorable Deanell R. Tacha, Circuit Judges and Honorable Wesley E. Brown, District Judge*

JUDGMENT

This cause came on to be heard upon the petitions for review of orders interpreting the statutory mandate in § 121 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3331, to deregulate certain natural gas prices. The matter was heard on the administrative record on the Commission and was argued by counsel.

Upon consideration whereof, it is ordered that the orders of the Federal Energy Regulatory Commission are affirmed in part. The orders are reversed in part. The cause is remanded to the Federal Energy Regulatory Commission for further proceedings consistent with the opinion of this court.

/s/ ROBERT L. HOECKER
Robert L. Hoecker
Clerk

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*The Honorable Wesley E. Brown, District Judge of the District of Kansas, sitting by designation.

APPENDIX D

Federal Energy Regulatory Commission

18 CFR Parts 270, 271, 272, 273, and 274

[Docket No. RM84-14-000]

Deregulation and Other Pricing Changes on January 1, 1985, Under the Natural Gas Policy Act

Issued: September 13, 1984.

AGENCY: Federal Energy Regulatory Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: On January 1, 1985, the Natural Gas Policy Act of 1978 (NGPA) will deregulate the prices for substantial amounts of interstate and intrastate gas. The Federal Energy Regulatory Commission (Commission) proposes to amend its regulations to prepare for price deregulation under section 121 of the NGPA for certain types of natural gas subject to sections 102, 103, 105, and 106 and new maximum lawful prices under sections 103(b) and 105(b)(3).

DATES: An original and 14 copies of comments must be filed by October 17, 1984. A public hearing will be held on October 11, 1984. Requests to participate in the public hearing must be submitted by October 4, 1984.

ADDRESS: All filings should refer to Docket No. RM84-14-000 and should be addressed to: Office of the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, D.C. 20426.

FOR FURTHER INFORMATION CONTACT:

Leslie Lawner, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, D.C. 20426 (202) 357-8511.

Ken Malloy, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, D.C. 20426 (202) 357-8033.

SUPPLEMENTARY INFORMATION: On January 1, 1985, the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301-3432 (1982), will deregulate the prices for substantial amounts of interstate and intrastate gas. The Federal Energy Regulatory Commission (Commission) proposes to amend its regulations to prepare for price deregulation under section 121 of the NGPA for certain types of natural gas subject to sections 102, 103, 105, and 106 and new maximum lawful prices under sections 103(b) and 105(b)(3).

I. Background

At the time Congress was considering the NGPA, oil prices were rising and increasing demand and declining supplies of natural gas created severe shortages in many parts of the nation. Political concern about these market distortions, as well as concern about the nation's energy dependence, led Congress to enact legislation revamping the natural gas pricing structure that had existed under the Natural Gas Act (NGA) and eventually to phase in market forces as a substitute for that structure for a substantial amount of our nation's gas supplies. Thus, in 1978, Congress deregulated some gas shortly after the enactment of the NGPA, provided for deregulation of prices for other categories of gas over the next decade, and retained regulatory and pricing controls on other gas wells until these wells are depleted.

Title I of the NGPA created several categories of natural gas, the first sale of which is subject to maximum lawful prices (ceiling prices). Those categories are based on a variety of factors, such as the date the well was

drilled, whether the gas was sold under intrastate contracts or committed or dedicated to interstate commerce (dedicated gas), and the need for incentives to produce gas that is otherwise difficult or uneconomical to produce. In contrast, the price of certain natural gas produced from completion locations deeper than 15,000 feet, geopressured brine, coal seams, or Devonian shale was deregulated in 1979, shortly after enactment of the NGPA. Moreover, under section 121, the price for some sections 102 and 103 gas and certain intrastate gas will be deregulated on January 1, 1985, while additional section 103 gas will be deregulated on July 1, 1987. In addition to price deregulation, Congress also mandated higher ceiling prices on January 1, 1985, for certain categories of gas under sections 103 and 105.

II. Discussion

This rulemaking generally concerns categories of natural gas that will be price deregulated under section 121. On January 1, 1985, section 121(a) eliminates price controls from "new natural gas" defined in section 102(c)[1] and certain gas produced from "new, onshore production wells" under section 103.[2] Subject to section 121(e), section 121 also deregulates the price of intrastate gas that is

[1] "New natural gas" under section 102(c) covers three types of gas: (1) Gas produced from the Outer Continental Shelf under a lease entered into after April 20, 1977; (2) gas produced from an onshore well on which surface drilling began on or after February 19, 1977, or the depth was increased by 1,000 feet on or after that date, and which is at least 2.5 miles from the nearest marker well or which is 1,000 feet deeper than the deepest completion location of any marker well within 2.5 miles; and (3) gas produced from a reservoir from which natural gas was not produced in commercial quantities before April 20, 1977, subject to certain exclusions. Section 121 deregulates all three types of gas.

[2] "New, onshore production wells" under section 103(c) are onshore wells on which surface drilling began on or after February 19, 1977,

subject to section 105 or 106(b) if the price paid for the last deliveries of such natural gas occurring on December 31, 1984 (or the price that would have been paid if no deliveries occurred on that date) is higher than $1.00 per MMBtu.[3]

The Commission has two goals in this rulemaking. The first is to resolve those legal and policy issues that are presented by deregulation of certain categories of gas under section 121. The second is to make technical amendments to the Commission's NGPA regulations to conform them to the pricing changes that will take effect on January 1, 1985.

A. Jurisdictional Agency Determinations

Section 503 establishes procedures under which well category determinations are made by State or Federal jurisdictional agencies and then reviewed by this Commission. Since enactment of the NGPA, this section and the Commission's implementing regulations have been used primarily for determining whether gas qualifies under a particular NGPA pricing category. With deregulation occurring on January 1, 1985, it appears that determinations will still be required before production can qualify for deregulated prices. This is due to the criteria that must be met before production qualifies for a deregulated category. Thus, even though section 121 deregulates the price of certain categories of gas, it appears that first

and from which gas is produced from a proration unit that meets certain requirements. Section 121 deregulates on January 1, 1985, the price of section 103 wells that were not committed or dedicated to interstate commerce on April 20, 1977, and that produce gas from a completion location deeper than 5,000 feet.

[3] Section 121(e) provides that, if the price for section 105 gas is over $1.00 per MMBtu because of the operation of an indefinite price escalator clause, gas will not be deregulated, but is subject to the ceiling prices in section 105(b)(3).

sellers must continue to file for determinations for certain categories of gas that will be price deregulated after the determination becomes final, where determinations previously have been required under Title I.

First, for sections 102 and 103 gas deregulated by section 121 and for which a producer has not filed for or obtained a determination prior to January 1, 1985, it appears that first sellers must continue to file applications for determinations with the appropriate jurisdictional agencies. The Commission is tentatively of the view that the NGPA requires a determination in this instance.

Under the determination process Congress established in section 503, jurisdictional agencies make certain factual findings about the well characteristics for certain categories of gas in Subtitle A of Title I of that Act. Subject to certain iterim [*sic*] collection procedures in section 503(e), an affirmative determination by the jurisdictional agency is a condition precedent to a first seller charging and collecting a specified price. Section 503 does not distinguish between gas that is regulated or deregulated, but attaches a substantive effect to a jurisdictional agency's application of the definitions in sections 102(c), 102(d), 103(c), 107(c) and 108(b). Nothing in section 503 or 121 indicates that Congress intended this substantive effect to be changed by deregulation on January 1, 1985. Thus, the Commission tentatively believes that the NGPA requires producers to obtain well category determinations, even for gas which will be price deregulated upon a final determination.

The Commission's approach to deregulation under section 107 followed this view. Under section 107(c), Congress deregulated the price of certain types of high-cost natural gas, *i.e.*, gas produced from completions below 15,000 feet, Devonian shale, geopressured brine, and occluded natural gas produced from coal seams. Section 503(a)(1) requires that a determination be made "applying

the definition of high-cost natural gas under section 107(c)." Similarly, section 107(c) requires that gas must be "determined in accordance with section 503 to be" high-cost gas. Given this NGPA mandate, the Commission required that producers obtain a determination in order for gas to be deregulated under section 107(c). This rule would adopt similar requirements for gas under sections 102(c) and 103 that will be deregulated on January 1, 1985.

The Commission is also considering alternative methods for meeting this statutory obligation. For example, it may be possible to establish a notice procedure similar to that used for obtaining qualifying status under section 210 of PURPA.[4] Under the procedure in § 292.207(a)(2), a party seeking to have qualifying status under PURPA for a cogeneration or small power production facility, may certify to the Commission in an informational filing that the facility meets the criteria in the rule, some of which are statutory in nature. The Commission requests comments on whether it has the authority under the NGPA to establish a similar procedure for well category determinations for deregulated gas and, if it does, whether such a procedure should be established. Comments are also invited on alternative means for carrying out the Commission's obligations under the statute, as well as the degree of latitude permitted by the statute.

Second, where a producer has already obtained a determination prior to January 1, 1985, that the gas qualifies as section 102(c) or 103 gas, the Commission is not proposing to require any additional determination that the gas is deregulated. Hence, the price for all section 102(c) or 103 gas that otherwise meets the prerequisites for deregulation is deregulated on January 1, 1985. Under this proposal, the producer would determine whether the gas meets any

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[4] Public Utility Regulatory Policies Act of 1978, 16 U.S.C. 2601, *et seq.*

additional criteria for a deregulation under section 121 of the NGPA. The Commission expects that pipelines will monitor a producer's decision as to whether or not the gas is deregulated. The Commission intends to review these decisions with audits and investigation of complaints.

Whether a section 103 application was filed before or after January 1, 1985, gas subject to that application must meet two criteria imposed by section 121 to be deregulated. It must not have been committed or dedicated to interstate commerce on April 20, 1977,[5] and it must be produced from a completion location deeper than 5,000 feet.[6] The Commission recognizes that it may have an

[5] For purposes of determining whether the gas was committed or dedicated to interstate commerce on April 20, 1977, the Commission intends to apply the definition in section 2(18) of the NGPA. Under the NGA, acreage subject to an interstate contract was not dedicated gas until gas actually commenced flowing in interstate commerce. Conversely, if no gas under the contract actually flowed in interstate commerce, then the gas was not dedicated gas under the NGA. Under section 2(18) of the NGPA, however, gas may be committed or dedicated to interstate commerce before flowing in interstate commerce, if, when sold, it "would be required to be sold in interstate commerce . . . under the terms of any contract, any certificate under the Natural Gas Act, or any provision of such Act." *See generally, Conoco, Inc.* v. *FERC*, 622 F.2d 796 (5th Cir. 1980); *Tenneco Exploration Ltd.* v. *FERC*, 649 F.2d 376 (5th Cir. 1981). Hence, gas which, if sold, would have been required to be sold in interstate commerce under the terms of any contract, Natural Gas Act (NGA) certificate, or provision of such Act would be deemed committed or dedicated to interstate commerce on April 20, 1977.

[6] For purposes of determining whether the completion location is located at a depth of more than 5,000 feet, the Commission proposes to amend § 272.104 to apply to section 103 gas. Section 272.104 currently applies to section 107(c) high-cost natural gas which must, among other things, be produced from a completion location deeper than 15,000 feet and requires that the measurement "shall be the true vertical depth from the surface location to the highest perforation point of the completion location." 18 CFR 272.104 (1983). The Commission believes it is appropriate to use the same measurement definition for section 103 gas as for section 107(c) gas because it would be consistent with our current practice.

obligation to review the deregulation criteria for section 103 gas before a first seller may charge and collect the deregulated price. Therefore, the Commission is considering requiring producers of such gas to file an affidavit, either separately or as part of a determination application, with the Commission and the purchasing pipeline that the section 103 gas meets these criteria. Alternatively, the Commission could require a standard section 503 determination by jurisdictional agencies with review by this Commission prior to deregulation taking effect. While we recognize these options, especially the latter, would impose a significant burden on applicants, jurisdictional agencies, and this Commission, the Commission requests comments on all aspects of these options including its statutory responsibilities to require such review.

Third, where an application for a determination is pending before a jurisdictional agency or this Commission on January 1, 1985, and becomes final after January 1, 1985, the Commission is proposing that the determination must become final before the gas qualifies for deregulation. This follows from the first proposal that producers should be required to obtain a determination even for gas that will be price deregulated after January 1, 1985.

The fourth instance concerns "new tight formation gas" under section 107(c)(5). In order to qualify as new tight formation gas, a producer must file the same information, in addition to other information, that would be filed to qualify as a section 102 or 103 determination. 18 CFR 274.205(e)(1)(i)(A) or (B) (1983). Thus, a determination that gas qualifies as new tight formation gas is implicitly a determination that the gas meets the qualifications for either section 102(c) or 103. Accordingly, for new tight formation gas for which a producer has received a final determination prior to January 1, 1985, such gas would be

deregulated under section 121 if the application contained the data and met the requirements for section 102(c) or 103 gas.

B. Interim Collection

The Commission's regulations state two different rules governing the price a first seller may collect while an application is pending before the Commission. The first rule applies to gas that is subject to a ceiling and for which a determination is required under the NGPA. In that situation, the Commission's current regulations allow producers, subject to contractual authorization, to collect the highest ceiling price for which they applied. 18 CFR 273.202(a)(1) and 273.203(a)(1) (1983). The second rule applies to gas that is deregulated under section 107 and for which a determination is required. In that situation, the Commission's regulations allow a producer, subject to contractual authorization, to collect only up to the section 102 price, not a higher deregulated contract price, while a determination is pending before a jurisdictional agency or this Commission. 18 CFR 273.202(a)(2) and 273.203(a)(2) (1983).

The Commission is proposing several changes to its interim collection regulations in light of deregulation on January 1, 1985. First, §§ 273.202(a)(2) and 273.203(a)(2) would be amended to apply not only to section 107 gas, but also to sections 102(c) and 103 deregulated gas. Secondly, and more importantly, the Commission is proposing to eliminate the section 102 price cap on interim collections and permit a producer to collect the deregulated price while an application for a determination for such gas is pending before a jurisdictional agency or this Commission. This rule would apply both for applications pending on January 1, 1985, and for those filed after January 1, 1985. The deregulated price should be the price that the producer and purchaser agree should be collected during the interim period.

The Commission's experience in reviewing over 165,000 determinations for sections 102, 103, and 107 gas indicates that producers file for the correct category of gas for these sections in over 96% of the cases. Thus, the Commission believes that in the vast majority of cases no refunds will be necessary under its proposed rule. However, if it is finally determined that the gas does not qualify under these sections, the producer will, of course, be required to refund the difference between the price collected and the otherwise applicable ceiling price, with interest. 18 CFR 154.102(c) and (d) (1983). Moreover, all other aspects of the Commission's current interim collection regulations would remain in effect for such gas, such as the surety bond or escrow requirement options.

C. Gas Qualifying for Both a Regulated and a Deregulated Category

There may be instances where gas produced from a well qualifies for two NGPA categories, one regulated and one deregulated. For example, gas that may qualify as section 103 deregulated gas under section 121 might also qualify as stripper well gas, which remains regulated under section 108 of the NGPA. Depending upon a producer's contracts, there may be some instances where it is more advantageous to the producer to collect a regulated price rather than a deregulated price. For example, in the current gas market, a producer may claim a contractual right to receive a higher price if the gas can remain under a regulated category than if the gas is not subject to any applicable ceiling price by operation of section 121 of the NGPA. Therefore, the Commission may have to interpret the NGPA as to whether the ceiling price provisions of the NGPA apply to gas that meets the criteria for both a regulated and deregulated category of gas.

The Commission believes that Congress intended all price controls for gas specified in section 121 to terminate on January 1, 1985, whether or not the gas continued to

qualify for a regulated price. This interpretation is consistent with the overall scheme envisioned by Congress when it enacted the NGPA—to provide incentive prices to encourage exploration and development of new reserves in the short-term, and to gradually substitute market forces for regulated prices by phasing in deregulation in 1985 and 1987.

Arguably, section 101(b)(5) provides producers a choice to remain regulated if the regulated price is higher than the deregulated price. That section provides that if natural gas "qualifies under more than one provision of this title providing for any maximum lawful price or any exemption from such a price . . ., the provision which could result in the highest price shall be applicable."

The Commission seeks comments on whether conflicts between regulated and deregulated gas prices are governed by this section, for example, on the theory that deregulation is not an "exemption for such price with respect to any first sale." Under this approach, Congress may have intended the language regarding "exemption," rather than referring to deregulation, to refer to instances in which the otherwise applicable ceiling price would not apply, such as special relief under sections 104, 106, and 109. Congress foresaw the possibility that in administering the well category ceiling prices, it was conceivable that some gas would qualify for more than one ceiling price. Hence, it sought to clarify that the "provisions that permit the seller to obtain the highest price" would apply. Joint Explanatory Statement of the Committee on Conference, H.R. Rep. No. 1752, 95th Cong., 2d Sess. 74 (1978). The issue is whether Congress intended this section to supersede the explicit statutory requirement of deregulation in section 121, when phased-in deregulation was one of its primary objectives in enacting the statute.

In any event, the Commission recognizes that there may be many instances in which there will be contract disputes

regarding the appropriate deregulated price allowed by the contract. For example, if a contract merely states that a producer can collect the "highest regulated price" for deregulated gas, the parties may disagree as to what that price is. These types of contract disputes should generally be resolved by the parties or the appropriate judicial forum. *See generally, Pennzoil Co.* v. *FERC*, 645 F.2d 360, 380-82 (5th Cir. 1981). The Commission nonetheless invites comments on whether this is the most appropriate procedure for resolving these disputes.

D. Contracts Under Section 105

1. Definition of Indefinite Price Escalator Clauses

As noted above, section 121 deregulates the price of intrastate contracts where the price paid on December 31, 1984, is higher than $1.00 per MMBtu provided that the price has not been established under an indefinite price escator clause as defined in section 105(b)(3)(B). Th[u]s, sales of gas under section 105 will be deregulated only if the price paid exceeds $1.00 on December 31, 1984, without the effect of an indefinite price escalator clause, but will not be deregulated if it exceeds $1.00 by virtue of the operation of an indefinite price escalator clause.

First, section 105(b)(3)(B) defines an indefinite price escalator clause as a clause

> which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference to other prices for natural gas, for crude oil, or for refined petroleum products; or . . . which allows for the establishment or adjustment of the price of natural gas delivered under such contract by negotiation between the parties.

In its Order No. 23 series,[7] the Commission found in general that for interstate contracts, most-favored-nations

[7] Final Regulations Amending and Clarifying Regulations Under the Natural Gas Act and the Natural Gas Policy Act, 44 FR 16895

clauses, price-reference clauses, certain redetermination clauses, FPC clauses, area rate clauses, and other such clauses are indefinite price escalator clauses.[8] The Commission believes that these findings are consistent with the definition of indefinite price escalator clauses in section 105(b)(3)(B) and should be used in applying that definition to intrastate contracts.

Second, while the Commission could rely on State or Federal courts to resolve contractual disputes as to whether a contract clause should be treated as an indefinite price escalator clause under section 105(b)(3)(B), the Commission requests comments on whether to allow the use of declaratory orders or NGPA interpretations of the General Counsel (18 CFR 385 207 and 385.1901 (1983)), or procedures similar to the Order No. 23 procedures to resolve such disputes. Since declaratory orders offer the parties the opportunity to obtain a binding resolution before the Commission, the Commission is proposing to specifically provide in § 271.506(a) that a petition for declaratory order be filed in instances where there is a conflict as to whether a contract clause meets the definition in NGPA section 105(b)(3)(B). While the Commission is inclined to exercise its own authority for purposes of determining what constitutes an indefinite price escalator clause and whether the gas subject to such a contract is deregulated, the Commission is inclined to

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(Mar. 20, 1979) (Order No. 23); 44 FR 34472 (June 15, 1979) (Order No. 23-B) (codified at 18 CFR § 154.94 (h) through (j) (1983)).

[8] In Order No. 23, the Commission was concerned with the issue of whether various contractual clauses provided contractual authority to collect NGPA maximum lawful prices. Here, however, the Commission is concerned not so much with interpreting the intent of parties to contracts but with whether certain pricing clauses fall within the definition of "indefinite price escalator clause."

leave other aspects of a contract's dispute (such as the price that can be charged under the contract) to be resolved by the parties or appropriate judicial forum.

2. Operation of the $1.00 per MMBtu Threshold

Other problems arise in determining whether the gas is actually priced above $1.00 on December 31, 1984. For example, some contracts may contain a definite pricing term which sets the price above $1.00 per MMBtu, without resorting to any indefinite price escalator clause that may also be in the contract. Thus, if the contract includes a definite price term setting the price at $1.10 per MMBtu and also an indefinite price escalator clause, the question arises as to whether the gas is deregulated, especially if the producer has used the indefinite clause to collect the section 102 price under the authority of section 105(b)(1).

The Commission believes that section 105(b)(3)(A) requires that the operation of the indefinite price escalator clause be the only mechanism by which the price is raised above $1.00 per MMBtu on December 31, 1984. Thus, in the above example, the gas would be deregulated. If Congress intended otherwise, it could have stated that all intrastate contracts with indefinite price escalator clauses remain regulated; there would be no need to reference the $1.00 threshold. Thus, the Commission is proposing in new § 271.506(b) that a contract will be deregulated if the fixed price that was or would have been collected under the contract is more than $1.00 per MMBtu.

A related problem arises when the price paid under an intrastate contract is based on a percentage of the proceeds from a subsequent sale (percentage sale). Determining whether the percentage sale price is above $1.00 per MMBtu on December 31, 1984, obviously presents the problem of determining a specific price paid on December 31, 1984. If conceived of as a daily price, a percentage sale price can fluctuate on a daily basis. For example, under a

percentage sale, the price of gas, if reported on a daily basis, may be above $1.00 on December 28, below a $1.00 on January 1, 1985, and above $1.00 again on January 3, 1985.

The Commission faced a similar problem in Order No. 68,[9] in which the Commission had to determine whether a percentage sale exceeded the section 105 and 106(b) ceiling price. The Commission noted that "the pricing mechanisms under sections 105 and 106(b) appear to assume a specific price stipulated by the terms of the contract." That order resolved this dilemma by reference to the subsequent resale between the percentage sale buyer and subsequent purchaser (resale contract). If the resale contract was within the ceiling price authorized by the NGPA, then the Commission assumed that the price paid under the percentage sale was within the ceiling price of the NGPA. The Commission noted that this was "the only practical course."

For purposes of determining whether section 105 gas subject to percentage sales contracts is priced above $1.00 per MMBtu and thereby deregulated, the Commission is proposing to follow the same rule established in Order No. 68. As proposed in § 271.506(c), if a resale contract that is the subject of a prior percentage sale is above $1.00 per MMBtu, the Commission will deem the percentage sale deregulated by operation of section 121. Conversely, if the price paid under the resale contract is below $1.00 per MMBtu on December 31, 1984, then the Commission will deem the percentage sale not deregulated by operation of section 121.

The Commission recognizes that under this proposal, there may be certain instances where the price paid under the resale contract is over $1.00 per MMBtu and the percentage given to the seller is less than $1.00 per MMBtu,

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[9] Rules Generally Applicable to Regulated Sales of Natural Gas and Ceiling Prices, 45 FR 5678 (Jan. 24, 1980) (Order No. 68).

and thus not technically eligible for price decontrol. The Commission believes that this problem is *de minimis*. Under section 105, the ceiling price for a percentage sale that remains regulated is the section 102 price ($3.73 – July 1984). The Commission believes that given the current surplus market, there will be few instances in which the price collected for a percentage sale of deregulated gas would exceed or equal the section 102 price. Thus, it makes little practical difference whether the Commission considers these percentage sales regulated or deregulated sales. Also, a decision to deregulate the percentage sale contract will have no rate impact on consumers since the resale contract will qualify for a deregulated price. The Commission is, therefore, inclined to follow Order No. 68's resolution of the percentage sale problem.

Alternatively, the Commission recognizes that it could require parties to percentage sale contracts to determine as closely as possible whether the price actually paid on December 31, 1984, is above or below $1.00 per MMBtu. The Commission is concerned that this option would entail considerable accounting and administrative burden to the parties and this Commission. However, the Commission requests comments on the proposal and this alternative as well as other administratively feasible techniques for determining whether a percentage sale exceeds the $1.00 per MMBtu threshold mandated in section 105 of the NGPA.

E. Other issues and conforming amendments

The Commission has indicated above those issues that it must resolve that relate to deregulation or new ceiling prices of certain gas in 1985. The Commission, however, wishes to be apprised of any other issues that commenters are aware of that will be presented by pending deregulation.

Many technical, conforming amendments must be made to the Commission's regulations implementing the NGPA in light of the changes that will be made under the NGPA on January 1, 1985. For example, the Commission's regulations relating to deregulated gas are codified in Part 272 and the regulations relating to regulated gas in Part 271. Since the price of gas subject to sections 102 and 103 is currently regulated, the regulations for these sections are contained in Part 271. Since most of the gas subject to these sections will be deregulated in 1985, the Commission has the choice of either amending Part 271 to reflect deregulation changes, or including in Part 272 the regulations that will apply to the deregulated gas under sections 102 and 103.

The Commission also has included technical and conforming changes that must be made to its NGPA regulations in the regulatory text of this proposal. For example, the table of ceiling prices listed at the end of § 271.101 is amended to reflect the new ceiling prices for sections 103 and 105 gas that remains regulated. While the Commission believes it has covered substantially all changes that must be made, it encourages comments on additional issues, and technical and conforming amendments in light of the changes that will be made by the NGPA in January of 1985.

III. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires certain statements, descriptions, and analyses of proposed rules that will have a "significant economic impact on a substantial number of small entities."[10] The Commission is not required to make such an analysis if it certifies that a proposed rule will not have a "significant economic impact on a substantial number of small entities."[11]

[10] 5 U.S.C. 603(a) (1982).

[11] *Id.* at section 605(b).

There are approximately 10,000 natural gas producers in the United States, many of which would be classified as small entities under the appropriate RFA definition.[12] This proposed rule might affect most of these entities by amending the filing requirements that must be followed for gas that will be deregulated on January 1, 1985. While these changes will be important in implementing deregulation under the Natural Gas Policy Act, the Commission does not believe that the burden imposed by these regulations will be significant. For the most part these regulations would merely make legal decisions and technical corrections necessary to implementing the statute. In those few instances were the Commission proposes to amend its regulations based on policy, the Commission believes that the economic impact, if any, will not be "significant." Accordingly, the Commission certifies that this rule, if promulgated, will not have a significant economic impact on a substantial number of small entities.

IV. Comment Procedures

The Commission invites interested persons to submit written comments, data, views, and other information concerning the matters set out in this notice. An original and 14 copies of such comments should be filed with the Commission by October 17, 1984. Comments should be submitted to the Office of the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, D.C. 20426 and should refer to Docket No. RM84-14-000. All written submissions will be placed in the Commission's public files and will be available for public inspection in the Commission's Office of Public

[12] *Id.* at section 601(3) *citing to* section 3 of the Small Business Act, 15 U.S.C. 632 (1982). Section 3 of the Small Business Act defines small business concern as a business which is independently owned and operated and which is not dominant in its field of operation.

Information, Room 1000, 825 North Capitol Street, NE., Washington, D.C. 20426, during regular business hours.

In addition, pursuant to section 502(b) of the NGPA, the Commission will hold a public hearing on October 11, 1984, at 10:00 a.m. Requests for participation in this hearing must be submitted by October 4, 1984. Requests should indicate the amount of time required for the oral presentation. Persons participating should, if possible, bring 25 copies of their presentation to the hearing.

This hearing will not be of a judicial or evidentiary type. There will be no cross-examination of persons presenting statements. However, the panel may question such persons and any interested person may submit questions to the presiding officer to be asked or persons making statements. The presiding officer will determine whether the question is relevant and whether the time limitations permit it to be presented. Any further procedural rules will be announced by the presiding officer at the hearing. Transcripts of the hearing will be available in the public file for this proceeding, Docket No. RM84-14-000, in the Commission's Division of Public Information.

List of Subjects in 18 CFR Parts 270 through 274

Natural gas, Incentive prices.

In consideration of the foregoing, the Commission proposes to amend Parts 270 through 274, Subchapter H, Chapter 1, Title 18 Code of Federal Regulation.

By direction of the Commission.

Kenneth F. Plumb
Secretary

PART 270—[AMENDED]

1. The authority citation for Part 270 is revised to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

2. Section 270.101(a) is amended by removing the words "high-cost" and inserting, in their place, the word "natural."

3. Section 270.101(c)(2) is revised to read as follows:

§ 270.101 Application of ceiling prices to first sales of natural gas.

* * * * *

(c) * * *

(2) The price of gas is deregulated only if such gas is deregulated natural gas as defined in § 272.103(a).

* * * * *

§ 270.102 [Amended]

4. Section 270.102(b)(14) is amended by removing the words "high-cost" and inserting, in their place, the word "natural."

5. A new § 270.208 is added to read as follows:

§ 270.208 Applicability of section 121.

Natural gas that is subject to section 121(a) of the NGPA shall be price deregulated and not subject to the maximum lawful prices of the NGPA, regardless of whether the gas also meets the criteria for some other category of gas subject to a maximum lawful price under Subtitle A of Title I of the NGPA.

PART 271—[AMENDED]

6. The authority citation for Part 271 is revised to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

7. Table I following § 271.101 is amended by adding a sentence at the end of footnote 1, adding footnotes 4, 5, and 6, adding a new designation E between designations C and F in the column reading "Subpart of Part 271" and revising designations B and C to read as follows:

§ 271.101 Ceiling prices for certain categories of natural gas.

* * * * *

TABLE I—NATURAL GAS CEILING PRICES
(OTHER THAN NGPA §§ 104 AND 106(a))

Subpart of part 271	NGPA section	Category of gas	*Maximum lawful price per MMBtu for deliveries in*
B	102	New natural gas, certain OCS gas[4]	* * *
C ...[1]	103	New, onshore production wells[5]	* * *
E	105(b)(3) .	Existing intrastate contracts[6]	

* * * * *

[1] * * * Commencing January 1, 1985, the price of some intrastate rollover gas is deregulated. (See Part 272 of the Commission's Regulations.)

* * * * *

[4] Commencing January 1, 1985, the price of natural gas finally determined to be eligible as new natural gas under section 102(c) is deregulated. (See Part 272 of the Commission's Regulations.)

[5] Commencing January 1, 1985, the price of some natural gas finally determined to be eligible as natural gas produced from a new, onshore production well under section 103 is deregulated. (See part 272 of the Commission's Regulations.)

[6] Prior to January 1, 1985, the maximum lawful price was the price specified in Subpart B of Part 271.

8. Section 271.201(a) is revised and the introduction text of the section is reprinted for the convenience of the reader:

§ 271.201 Applicability.

This subpart implements section 102 of the NGPA and applies to the first sale of:

(a) new natural gas which is not deregulated natural gas (see § 272.103(a)); or

* * * * *

9. Section 271.301 is revised to read as follows:

§ 271.301 Applicability.

This subpart implements section 103 of the NGPA and applies to the first sale of natural gas produced from a new, onshore production well, if such gas is not deregulated natural gas (see § 272.103(a)).

10. Section 271.501 is amended by revising the first sentence to read as follows:

§ 271.501 Applicability.

This subpart implements section 105 of the NGPA and applies to the first sale of natural gas under an existing intrastate contract or under a successor to a intrastate contract, if such natural gas is not deregulated natural gas (see § 272.103(a)). * * *

11. Section 271.502(a) is amended by removing the heading "November 9, 1978, contract price at or below $2.06 per MMBtu."

12. Section 271.502 is amended by removing the heading for paragraph (b), revising the introductory text of paragraph (b) and paragraph (b)(1) to read as follows:

§ 271.502 Maximum lawful prices.

* * * * *

(b) In the case of a first sale of natural gas to which this subpart applies and for which the price paid exceeds $1.00 per MMBtu on December 31, 1984 (or would exceed $1.00 per MMBtu if sold on such date) solely by operation of an indefinite escalator clause, the maximum lawful price for natural gas delivered in any month shall be the higher of:

(1) the maximum lawful price per MMBtu for such month specified for Subpart E of Part 271 in Table I of § 271.101(a); or

* * * * *

13. A new § 271.506 is added to read as follows:

§ 271.506 Rules related to deregulation of intrastate gas.

(a) *Indefinite price escalator clauses.* In any case where there is a controversy over whether a particular contract clause is an indefinite price escalator clause under section 105(b)(3)(B), a petition for a declaratory order under § 385.207 of the Commission's regulations shall be filed.

(b) *Contracts over $1.00 by virtue of a definite price clause.* The price of natural gas subject to this subpart is deregulated if the price paid under a clause other than an indefinite price escalator clause is higher than $1.00 per MMBtu for the last deliveries of such gas occurring on December 31, 1984, or if no deliveries occurred on such date, the price that would have been paid had deliveries occurred on such date.

(c) *Percentage-of-proceeds sales.* The price of natural gas sold under a percentage-of-proceeds contract subject to this subpart is deregulated if the price paid on the resale contract is deregulated under Part 272. (§ 270.202(b) states other rules for percentage-of-proceeds sales.)

14. Section 271.601 is revised to read as follows:

§ 271.601 Applicability.

This subpart implements section 106(b) of the NGPA and applies to the first sale of natural gas under an intrastate rollover contract, if such natural gas is not deregulated natural gas (see § 272.103(a)).

PART 272—[AMENDED]

15. The authority citation for Part 272 reads as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

§§ 272.101 and 272.102 [Amended]

16. Sections 272.101 and 272.102 are amended by removing the words "high-costs" and inserting, in their place, the word "natural."

17. In § 272.103, paragraph (a) is revised to read as follows:

§ 272.103 Definitions.

(a) "Deregulated natural gas" means:

(1) Natural gas for which a jurisdictional agency determination has become final under Parts 274 and 275 that the gas qualifies as:

(i) deep, high-cost natural gas;

(ii) gas produced from geopressured brine;

(iii) occluded natural gas produced from coal seams; or

(iv) gas produced from Devonian shale.

(2) Natural gas for which a jurisdictional agency determination becomes final under Parts 274 and 275 and which is sold in a first sale on or after January 1, 1985, and such gas qualifies as:

(i) new natural gas as defined in § 271.203;

(ii) natural gas produced from any new, onshore production well if such gas as defined in § 271.303:

(A) was not committed or dedicated to interstate commerce (as defined in NGPA section 2(18)) on April 20, 1977; and

(B) is produced from a completion location which is located at a depth of more than 5,000 feet.

(3) Natural gas sold under an existing intrastate contract, any successor to an existing contract or any rollover contract, if:

(i) such natural gas was not committed or dedicated to any interstate commerce on November 8, 1978; and

(ii) the price paid under a clause other than an indefinite price escalator clause for the last deliveries of such natural gas occurring on December 31, 1984, or, if no deliveries occurred on such date, the price that would have been paid had deliveries occurred on such date is higher than $1.00 per MMBtu.

* * * * *

18. Section 272.104 is revised to read as follows:

§ 272.104 Special rules for measuring the depth of deregulated natural gas.

For purposes of determining the depth of a completion location under §§ 272.103(a)(2)(ii)(B) and 272.103(b), measurement shall be the true vertical depth from the surface location to the highest perforation point in the completion location.

PART 273—[AMENDED]

19. The authority citation for Part 273 is revised to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

20. Section 273.202(a)(2) is revised to read as follows:

§ 273.202 Collection pending jurisdictional agency determination of eligibility.

(a) * * *

(2) If an application has been filed with the jurisdictional agency for a determination of elibility under Part 272 (relating to deregulated natural gas), the deregulated price may be charged pending the jurisdictional agency determination.

* * * * *

21. Section 273.203(a)(2) is revised to read as follows:

§ 273.203 Collection pending review of jurisdictional agency determination.

(a) * * *

(2) If a jurisdictional agency has determined in accordance with Part 274 that natural gas qualifies under Part 272 (relating to deregulated natural gas), the seller may charge and collect the deregulated price during the period described in paragraph (b) of this section.

* * * * *

22. In § 273.204, a new paragraph (a)(1)(iv) is added to read as follows:

§ 273.204 Retroactive collection after final determination.

(a) * * *

(1) * * *

(iv) in the case of a new natural gas (as defined in § 271.203) and natural gas produced from a new, onshore production well (as defined in § 271.303) which also satisfies the criteria of § 272.103(a)(3), if the application for determination was filed on or before January 1, 1985, then for the first sales of such natural gas delivered on or after January 1, 1985, the seller may retroactively collect

the amount by which the deregulated price exceeds the price collected during such period.

* * * * *

§ 273.204 [Amended]

23. Section 273.204(a)(2) is amended by removing the words "Part 272" and inserting, in their place, the words "§ 272.103.103(a)(1)."

PART 274—[AMENDED]

24. The authority citation for Part 274 is revised to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-34342; Department of Energy Organization Act, 42 U.S.C. 7101-7352.

25. Section 274.101 is amended by revising the introductory language to read as follows:

§ 274.101 Applicability.

This part applies to determinations of jurisdictional agencies (as defined in § 274.501) made under § 272.103(a)(1) and the following subparts of Part 271:

* * * * *

APPENDIX E

Federal Energy Regulatory Commission

18 CFR Parts 270, 271, 272, 273, and 274

[Docket No. RM84-14-000; Order No. 406]

Deregulation and Other Pricing Changes on January 1, 1985, Under the Natural Gas Policy Act

Issued: November 16, 1984.

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Final rule.

SUMMARY: On January 1, 1985, the Natural Gas Policy Act of 1978 (NGPA) will deregulate the prices for substantial amounts of interstate and intrastate gas. The Federal Energy Regulatory Commission (Commission) is amending its regulations to prepare for price deregulation under section 121 of the NGPA for certain types of natural gas subject to sections 102, 103, 105, and 106, and is publishing new maximum lawful prices under sections 103(b) and 105(b)(3).

EFFECTIVE DATE: January 1, 1985.

FOR FURTHER INFORMATION CONTACT:

Peter J. Roidakis, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, D.C. 20426, (202) 357-8511.

Elisabeth Pendley, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, D.C. 20426, (202) 357-8511.

SUPPLEMENTARY INFORMATION:

Before the Commissioners: Raymond J. O'Connor, Chairman; Georgiana Sheldon, A.G. Sousa, Oliver G. Richard III, and Charles G. Stalon.

I. Introduction

The Federal Energy Regulatory Commission (Commission) is issuing a final rule implementing section 121 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301-3432 (1982). On January 1, 1985, NGPA section 121 will deregulate the prices for substantial amounts of interstate and intrastate gas.

In general, this final rule states: (1) That jurisdictional agency determinations are still necessary for section 102 and section 103 gas after January 1, 1985; (2) that first sellers may make interim collections at the agreed to deregulated price; (3) that gas which qualifies for both a regulated and a deregulated category will be deregulated; (4) that contract prices for intrastate contracts above $1.00 per MMBtu by virtue of a definite price clause will be deregulated.

II. Background

At the time Congress was considering the NGPA, oil prices were rising and increasing demand and declining supplies of natural gas created severe shortages in many parts of the nation. Political concern about these market distortions, as well as concern about the nation's energy dependence, led Congress to enact legislation revamping the natural gas pricing structure that had existed under the Natural Gas Act (NGA), 15 U.S.C. section 717-717w (1982), and eventually to phase in market forces as a substitute for that structure for a substantial amount of our nation's gas supplies. Thus, in 1978, Congress deregulated some gas shortly after the enactment of the NGPA, provided for deregulation of prices for other categories of gas over the next decade, and retained regulatory and pricing controls on other gas wells until these wells are depleted.

Title I of the NGPA created several categories of natural gas, the first sale of which is subject to maximum

lawful prices (ceiling prices). Those categories are based on a variety of factors, such as the date the well was drilled, whether the gas was sold under intrastate contracts or committed or dedicated to interstate commerce (dedicated gas), and the need for incentives to produce gas that is otherwise difficult or uneconomical to produce. In contrast, the price of certain natural gas produced from completion locations deeper than 15,000 feet, geopressured brine, coal seams, or Devonian shale was deregulated in 1979, shortly after enactment of the NGPA. Moreover, under section 121, the price for section 102(c) and some section 103 gas and certain intrastate gas will be deregulated on January 1, 1985, while additional section 103 gas will be deregulated on July 1, 1987. In addition to price deregulation, Congress also mandated higher ceiling prices on January 1, 1985, for certain categories of gas under sections 103 and 105. Since the enactment of the NGPA, many changes have occurred in the natural gas markets. One development, unforeseen by the drafters of the NGPA, is the current supply surplus of natural gas, however temporary or long-lived it may prove to be. This oversupply factor is an important consideration in understanding the controvery surrounding "dually qualified" wells, as discussed below.

In general, this rulemaking concerns categories of natural gas that will be price deregulated under section 121. On January 1, 1985, section 121(a) eliminates price controls from "new natural gas" defined in section 102(c)[1] and certain gas produced from "new, onshore production

[1] "New natural gas" under section 102(c) covers three types of gas: (1) gas produced from the Outer Continental Shelf under a lease entered into on or after April 20, 1977; (2) gas produced from an onshore well on which surface drilling began on or after February 19, 1977, or the depth was increased by 1,000 feet on or after that date, and which is at least 2.5 miles from the nearest marker well or which is 1,000 feet deeper than the deepest completion location of any marker well within 2.5 miles; and (3) gas produced from a reservoir from

wells" under section 103.[2] Except for gas that is subject to section 121(e), section 121 also deregulates the price of intrastate gas that is categorized as section 105 or 106(b) gas, if the price paid for the last deliveries of such natural gas occurring on December 31, 1984 (or the price that would have been paid if no deliveries occurred on that date), is higher than $1.00 per MMBtu.[3]

The Commission has two goals in this rulemaking. The first is to resolve those legal and policy issues that are presented by deregulation of certain categories of gas under section 121. The second task is to make technical amendments to the Commission's NGPA regulations to conform them to the pricing changes that will take effect on January 1, 1985.

On September 13, 1984, the Commission proposed to amend its regulations to prepare for price deregulation under section 121 of the NGPA for certain types of natural gas subject to sections 102, 103, 105, and 106 and to publish new maximum lawful prices under sections 103(b) and 105(b)(3).[4]

The Commission received approximately 100 substantive comments to this rulemaking—45% representing producer interests, 25% representing pipeline interests and

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which natural gas was not produced in commercial quantities before April 20, 1977, subject to certain exclusions.

[2] "New, onshore production wells" under section 103(c) are onshore wells on which surface drilling began on or after February 19, 1977, and from which gas is produced from a proration unit that meets certain requirements. Section 121 deregulates on January 1, 1985, the price of section 103 wells that were not committed or dedicated to interstate commerce on April 20, 1977, and that produce gas from a completion location deeper than 5,000 feet.

[3] *See* Section 121(e).

[4] Notice of Proposed Rulemaking, 49 FR 36399 (Sept. 17, 1984) (Docket No. RM84-14-000).

30% from utilities, local distribution companies, and consumer groups. Numerous personal letters from royalty owners, investors, and other individuals were received.

III. Discussion

A. Jurisdictional Agency Determinations

Section 503 established procedures under which well category determinations are made by State or Federal jurisdictional agencies and then reviewed by this Commission. Since enactment of the NGPA, this section and the Commission's implementing regulations have been used primarily for determining whether gas qualifies under a particular NGPA pricing category.

The Commission's proposal discussed several circumstances in which it must decide if section 503 determinations would be required after several categories of gas are deregulated after January 1, 1985. Even though section 121 deregulates the price of certain categories of gas, the NGPA requires first sellers to continue to file for determinations for certain categories of gas that will be price deregulated after the determination becomes final, where determinations previously have been required under Title I.

1. Determinations for Gas That Will Be Deregulated

For sections 102 and 103 gas deregulated by section 121 and for which a producer has not filed for or obtained a determination prior to January 1, 1985, first sellers must continue to file applications for determinations with the appropriate jurisdictional agencies. The Commission proposed that the NGPA requires a determination in this instance. The vast majority of commenters supported the Commission's reading of the NGPA, but requested that the Commission simplify its section 503 filing requirements.

Under the determination process Congress established in section 503, jurisdictional agencies make certain factual findings about the well characteristics for certain categories of gas in Subtitle A of Title I of that Act. Subject to certain interim collection procedures in section 503(e), an affirmative determination by the jurisdictional agency is a condition precedent to a first seller charging and collecting a specified price. Section 503 does not distinguish between gas that is regulated or deregulated, but attaches a substantive effect to a jurisdictional agency's application of the definitions in sections 102(c), 102(d), 103(c), 107(c) and 108(b). Nothing in sections 503 or 121 indicates that Congress intended this substantive effect to be changed by deregulation on January 1, 1985. Thus, the Commission believes that the NGPA requires producers to obtain well category determinations, even for gas which will be price deregulated after a final determination.

As we noted in the proposal, the Commission's approach to deregulation under section 107 followed this view. Under section 107(c)(1)-(4), Congress deregulated the price of certain types of high-cost natural gas, *i.e.*, gas produced from completions below 15,000 feet, Devonian shale, geopressured brine, and occluded natural gas produced from coal seams. Section 503(a)(1) requires that a determination be made "applying the definition of high-cost natural gas under section 107(c)." Similarly, section 107(c) requires that gas must be "determined in accordance with section 503 to be" high-cost gas. Given this NGPA mandate, the Commission required that producers obtain a determination in order for gas to be deregulated under section 107(c). This rule would adopt similar requirements for gas under sections 102(c) and 103 that will be deregulated on January 1, 1985.

With regard to commenter's suggestions that the Commission simplify its section 503 filing requirements, the

Commission notes that it recently completed a rulemaking which substantially reduced the burden imposed in filing for determinations.[5]

Furthermore, because some jurisdictional agencies require certain filing requirements in addition to those required by the Commission, the Commission urges jurisdictional agencies to consider streamlining their filing requirements for section 102 and section 103 final determinations by reducing them to the minimum required by the Commission. The jurisdictional agencies must give written notice of any change in its procedures as described in § 274.105(b). Jurisdictional agencies might also consider filing an alternative plan with the Commission under § 274.207 to further decrease the burdensome filings and thereby streamline the section 102 and section 103 determination process. However, these alternative plans must satisfy the section 503 statutory requirement for substantial evidence.

2. Gas for Which Determinations Have Already Been Received

The Commission proposed that, if a producer has already obtained a determination prior to January 1, 1985, that the gas qualifies as section 102(c) or 103 gas, no additional determination that the gas is deregulated is required by the NGPA. Hence, the price for all section 102(c) or 103 gas that otherwise meets the prerequisites for deregulation is deregulated on January 1, 1985. Commenters supported this view. Under this approach, producers would determine whether the gas meets any additional criteria for deregulation under section 121 of the NGPA. The commission expects that pipelines will

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[5] Reduction in Filing Requirements for Well Category Applications Under Sections 102, 103, 107 and 108 of the Natural Gas Policy Act of 1978, 48 FR 44508 (Sept. 29, 1983) (Order No. 336); 49 FR 566 (Jan. 5, 1984) (Order on Rehearing).

monitor a producer's decision as to whether or not the gas is deregulated. The Commission intends to review these decisions with audits and investigation of complaints.

The Commission requested comment on whether additional filing requirements were necessary for section 103 gas that had already received a determination. Section 103 gas must meet two criteria to be deregulated. It must not have been committed or dedicated to interstate commerce on April 20, 1977,[6] and it must be produced from a completion location deeper than 5,000 feet.[7] The Commission

[6] For purposes of determining whether the gas was committed or dedicated to interstate commerce on April 20, 1977, the Commission intends to apply the definition in section 2(18) of the NGPA. Under the NGA, acreage subject to an interstate contract was not dedicated gas until gas actually commenced flowing in interstate commerce. Conversely, if no gas under the contracts actually flowed in interstate commerce, then the gas was not dedicated gas under the NGA. Under section 2(18) of the NGPA, however, gas may be committed or dedicated to interstate commerce before flowing in interstate commerce, if, when sold, it "would be required to be sold in interstate commerce . . . under the terms of any contract, any certificate under the Natural Gas Act, or any provision of such Act." *See* generally, Conoco, Inc. v. FERC, 622 F.2d 796 (5th Cir. 1980); Tenneco Exploration Ltd. v. FERC, 649 F.2d 376 (5th Cir. 1981). Hence, gas which, if sold, would have been required to be sold in interstate commerce under the terms of any contract, Natural Gas Act (NGA) certificate, or provision of such Act would be deemed committed or dedicated to interstate commerce on April 20, 1977. With regard to infill wells, if the entire acreage comprising the proration unit is dedicated, then subsequent infill wells could not qualify for the deregulated price.

[7] For purposes of determining whether the completion location is located at a depth of more than 5,000 feet, the Commission proposes to amend § 272.104 to apply to section 103 gas. Section 272.104 currently applies to section 107(c) high-cost natural gas which must, among other things, be produced from a completion location deeper than 15,000 feet and requires that the measurement "shall be the true vertical depth from the surface location to the highest perforation point of the completion location." 18 CFR 272.104 (1983). The Commission believes it is appropriate to use the same measurement definition for section 103 gas as for section 107(c) gas, as consistent with our current practice. No comments opposing this proposal were received.

requested comment on whether it has an obligation to review these deregulation criteria for section 103 gas before a first seller may charge and collect the deregulated price. The Commission considered requiring producers of such gas to file an affidavit, either separately or as part of a determination application, with the Commission and the purchasing pipeline that the section 103 gas meets these criteria. Alternatively, the Commission indicated that it might require a standard section 503 determination by jurisdictional agencies with review by this Commission prior to deregulation taking effect.

Commenters were overwhelmingly opposed to requiring any additional filing requirements for section 103 gas. These commenters supported the Commission's general approach of relying on pipelines to monitor these situations and to rely on audits and complaints. The Commission believes that it is not necessary to impose additional filing requirements at this time. These requirements would impose unnecessary burdens on applicants, jurisdictional agencies and this Commission in a situation where less burdensome alternatives exist for ensuring that the requirements of the NGPA will be adequately met.

Similarly, the Commission believes that post-January 1, 1985 section 103 determinations must receive treatment identical to that received by pre-January 1, 1985 section 103 determinations for deregulation. Therefore, all pending and prospective section 103 applications automatically deregulate once the section 103 determination is final, provided that the dedication and depth requirements are met. Neither an additional filing requirement such as an affidavit nor a second "deregulation" determination are necessary to implement the dedication and depth requirements in section 121.

Also, the Commission expects pipelines to monitor a producer's decision as to whether a well is deregulated. The Commission will review these decisions with audits

and investigation of complaints. Pipelines complained of the additional monitoring burden and the increased cost to the consumer. In order to minimize this potential burden, the Commission will require the producer to file an affidavit with the pipeline at the pipeline's request, presenting information on the dedication and depth of the well. As a result, the pipeline will not need to invest resources to obtain this information.

3. Pending Determinations

Where an application for a determination is pending before a jurisdictional agency or this Commission on January 1, 1985, and becomes final after January 1, 1985, the Commission proposed that the determination must become final before the gas qualifies for deregulation.[8] This follows from the Commission's proposal that producers should be required to obtain a determination even for gas that will be price deregulated after January 1, 1985.[9] Commenters supported this approach and it is adopted for the reasons stated above.

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[8] Several commenters request clarification of whether the "effective date" of deregulation, for any well is the date on which it is determined to qualify for a deregulated category, the date for which such determination is filed or some other date. A multiplicity of dates for deregulation, depending on when the wells qualify for a deregulated category could make contract administration confusing. Just as the NGPA provided for section 107(c)(1-4) gas to be deregulated on November 1, 1979, the NGPA provides a date certain (January 1, 1985) for deregulation. Collection of the deregulated prices as of that date is, we emphasize, a matter of contract, however, subject to the need for a final determination (for section 102 and 103 gas) and the related dedication and depth requirements.

[9] Although somewhat unclear, some commenters appear to ask whether a producer that is charging the higher section 102(c) incentive price for gas that has also been eligible since 1979 for a lower deregulated price under section 107(c)(1-4), will be liable to refund the difference between the section 102(c) price and the otherwise applicable contract price for deregulated gas for past periods. In this

B. Interim Collection

The Commission's regulations state two different rules governing the price a first seller may collect while an application for a determination of the applicable category of gas is pending before the jurisdictional agency or this Commission. The first rule applies to gas that is subject to a ceiling price and for which a determination is required under the NGPA. In that situation, the Commission's current regulations allow producers, subject to contractual authorization, to collect the highest ceiling price for which they applied. 18 CFR 273.202(a)(1) and 273.203(a)(1) (1983). The second rule applies to gas that is deregulated under section 107(c)(1)-(4) and for which a determination is required. In that situation, the Commission's regulations allow a producer, subject to contractual authorization, to collect only up to the section 102 price, not a possibly higher deregulated price, while a determination is pending before a jurisdictional agency or this Commission. 18 CFR 273.202(a)(2) and 273.203(a)(2) (1983).

The Commission proposed several changes to its interim collection regulations in light of deregulation on January 1, 1985. First, the interim collection provisions of the regulations would be amended to apply not only to section 107(c)(1)-(4) gas, but also to sections 102(c) and 103 deregulated gas. Secondly, the Commission proposed to eliminate the section 102 price cap on interim collections and permit a producer to collect the price agreed upon by the parties while an application for a determination for such gas is pending before a jurisdictional agency or this Commission. This rule would apply both for applications pending on January 1, 1985, and for those filed after January 1, 1985. The deregulated price would be the price

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situation, no actual violation of the NGPA maximum lawful price has occurred. However, there may be questions raised as to the price paid under the contract. Such contractual disputes should be resolved by the parties in the appropriate judicial forum.

that the producer and purchaser agree should be collected during the interim period, and thereafter, once the well finally qualifies for a deregulated category.

A relatively small number of commenters addressed this proposal. Commenters suggested that although producers file for the correct NGPA category 96% of the time, this still means an *incorrect* filing rate of 4%, which, in absolute dollar amount, can be substantial. Based on this observation, these commenters request that the section 102 price ceiling continue to be used as a price cap for interim collections either on public policy grounds that the "refund remedy" for incorrect category filings is not, as a practical matter, an adequate remedy, or on the theory that, if regulatory restraints are further lifted, as proposed, the error rate may far exceed the 4% error rate now prevailing. One commenter requested that the escrow and refund protections of interim collection (18 CFR 273.302 and 18 CFR 154.102(c) and (d), respectively), remain intact to protect pipelines and downstream customers from overcollection.

The rule adopted by the Commission extends interim collection procedures to sections 102(c) and 103 gas and removes the current price limitation in favor of whatever price the parties agree to. The Commission still believes that the new rule will not necessitate more refunds than under current regulations. If it is finally determined that the gas does not qualify under a deregulated section, however, the producer will be required to refund the difference between the price collected and the otherwise applicable ceiling price, with interest. 18 CFR 154.102(c) and (d) (1983). The Commission believes this refund remedy is adequate. As requested, all other aspects of the Commission's current interim collection regulations will remain in effect for such gas, such as the surety bond or escrow options.

One commenter made the point that the proposed rule sets the interim rate at the "contract rate" rather than limiting it to the section 102 ceiling rate. Other commenters asked that the Commission clarify whether the "contract rate" was intended to be the new interim rate, or whether a separate "agreed upon" interim rate was intended. The Commission emphasizes that it intends that, in the final rule, an agreed-upon rate will govern interim collections. However, if the parties are entitled to renegotiate the price upon deregulation, they need do so only once. The agreed-upon interim deregulated price may continue to serve as the deregulated price, once the gas is ultimately determined to be deregulated.

C. Dual Qualification Gas

Some gas qualifies for two NGPA categories: one regulated under a maximum lawful price and one which will be deregulated on January 1, 1985. Examples of this dually qualified gas are new tight formation gas (section 107(c)(5)) which also qualifies as section 102 or section 103 gas in order to receive the incentive price and some stripper well gas (section 108) which also qualifies as section 102 or section 103 or section 105 deregulated gas. Many contracts contain two clauses—one which sets the price if gas is regulated and one which is implemented if gas is deregulated. Producers would prefer to collect under the regulated category if the regulated price is higher than the deregulated price. Pipeline purchasers, on the other hand, want to renegotiate the gas price to arrive at a deregulated price which they believe will be lower than the regulated rate. By choosing to remain regulated, the producer may avoid renegotiation and the potential lowering of its contract price under current market conditions. And, in turn, the pipeline may be thwarted in renegotiating a new contract price.

The Commission proposed that gas that qualified for both a regulated and a deregulated category will be considered deregulated and the price would be collected under the clause of the contract governing deregulated gas. The Commission believed that Congress intended all price controls for gas specified in section 121 to terminate on January 1, 1985, whether or not the gas continued to qualify for a regulated price. This interpretation, the Commission noted, was consistent with the overall scheme envisioned by Congress when it enacted the NGPA—to provide incentive prices to encourage exploration and development of new reserves in the short-term, and to gradually substitute market forces for regulated prices by phasing in deregulation in 1985 and 1987.

Numerous comments were filed on this significant deregulation issue. Unlike comments filed by producers in previous years,[10] producer and royalty interest owner

[10] Contrary to producers' current pro-regulation stance, they formerly argued for decontrol of tight formation gas on January 1, 1985, if such wells qualify. Numerous comments were filed by producers in Docket No RM79-76, Interim Rule Covering High-Cost Natural Gas Produced from Tight Formations, 45 FR 13414 (February 28, 1980). The following comment is typical of those presented by producers: "If a well qualifying as a 'tight' formation well also qualifies under section 102, then gas produced from that well will be price deregulated as of January 1, 1985. Similarly, if the Commission maintains its present requirement that any 'tight' formation well must also be a section 103 well, then gas from any such well *must* be price deregulated as of January 1, 1985, or July 1, 1987, depending on the depth of the well. Quite simply, the NGPA vests no discretion in the Commission in this regard. Thus, the fact that a well qualifies as a 'tight' formation well under any regulation ultimately issued has absolutely no impact upon the question of whether the gas produced from such well will otherwise be price deregulated pursuant to the provisions of Section 121 if it also qualifies under a deregulated category." Pennzoil Co. *et al.*, October 30, 1979, comments at 14, Docket No. RM79-76.

comments argued that the producer could choose to remain regulated under section 101(b)(5) and the NGPA does not require that this gas be deregulated. Many producers argue that they will be forced to shut in wells if these wells are deregulated because the prices will be uneconomic after renegotiation with pipelines. They argue that this would cause them severe economic hardship and would deprive the nation of needed gas reserves. Producers also argue that they would not have invested in tight formation wells (section 107(c)(5)) if they had known that this gas would be deregulated on January 1, 1985.

Comments from pipelines, gas associations, utilities and consumer groups supported the Commission's proposal, arguing that dually-qualified gas deregulated on January 1, 1985.

At the time the NGPA was crafted, it was assumed that the deregulated price would be equal to or exceed the otherwise applicable regulated maximum lawful prices. However, this probably will not be the case on January 1, 1985. Market prices are currently lower than the section 102 and section 103 ceiling prices. Admittedly, Congress may not have anticipated such a situation. It did, however, enact the NGPA in the belief that the marketplace could ascertain the value of a commodity in relation to supply and demand and allocate gas resources better than the regulated environment. Deregulation will accelerate the market trend to competitive affordable gas prices.

1. Section 121 Mandates Deregulation

The Commission believes that the position it took in its proposal is legally correct. Gas that is dually qualifed must be considered deregulated under the NGPA. The Commission believes that it is implementing Congress' intention to phase in deregulation of natural gas. Section 121 states that all maximum lawful prices for certain categories of natural gas, namely gas under sections 102(c) and 103(c),

"shall * * * cease to apply effective January 1, 1985 * * *." Therefore, gas that qualifies both under section 107(c)(5) or 108 *and* sections 102 or 103 will be deregulated, provided that section 103 gas meets the dedication and depth requirements. Deregulation appears to be mandatory. Producers cannot opt out of the statutory scheme on January 1, 1985, merely because market conditions are unfavorable. The Commission finds more persuasive the comments filed by producers on this issue in previous proceedings, where they too perceived a statutory mandate to deregulate.[11]

To ignore this fact invalidates the Congressional intent evident in the NGPA scheme of phased decontrol. The NGPA was created to phase from regulated ceiling prices in the short term to market clearing prices in the long term. Producers complain because market prices are currently lower than regulated prices. Under deregulation, the ability to negotiate a contract above the old regulated ceiling price is always possible.

With a different future market in mind, Congress allowed dual determinations to expedite the determination process and to prepare for the deregulation process. Quoting from the *Congressional Record*, October 14, 1978, H 13115-17:

> Another way in which dual determination requests could be appropriate would be in cases in which one determination would yield a short term benefit, while another a long term advantage. Such could be the case where a new well produces new gas and also qualifies as a stripper well. A single proceeding to determine qualification for both designations would permit the producer to obtain stripper well pricing under section 108 prior to January 1, 1985 and

[11] See, n.10, *supra*.

> deregulation as new gas thereafter. In the long run a single state proceeding might present less administrative burdens than a subsequent proceeding in which a classification not previously requested is sought.

It is our statutory obligation to interpret and implement the NGPA. It is our belief that the statutory intent to deregulate takes precedence over the statute's increased supply objective. Thus when the deregulation date of January 1, 1985 is reached, section 121—being the last provision in point of arrangement (Subsection B), and detailing deregulation specifically—is the controlling section.[12] The maximum lawful ceiling prices for section 107(c)(5) and section 108 gas which also qualifies as section 102 or section 103 deregulated gas no longer exist. The statutory language mandates deregulation of gas qualifying for a regulated and deregulated category on January 1, 1985. It is this statutorily-mandated deregulation that may trigger the parties' contractual agreements, with subsequent economic consequences.[13]

[12] Basic rules of general statutory construction and interpretation state that (1) when a conflict in a statute exists, the last provision in point of arrangement [within the statute] must control; Lodge 1858, Am. Fed. of Gov't Emp. v. Webb, 580 F.2d 496 (D.C. Cir. 1978); (2) [s]pecific terms will prevail over the general [terms] in the same or another statute which otherwise might be controlling; Lodge 1858, supra, *quoting* Ginsberg & Sons v. Popkin, 285 U.S. 204; (3) all sections must be reconciled so as to produce a symmetrical whole. Federal Power Comm. v. Panhandle Eastern Pipeline Col., 337 U.S. 498 (1949).

[13] Some producers raised an issue concerning the tax credit election available for tight formation wells under the Crude Oil Windfall Profits Tax Act, sections 231(a) and (b). These provisions have been cited in support of the proposition that tight formation gas was intended by Congress to be forever regulated, even if dually-classified as section

2. The Effect of Section 101(b)(5)

The Commission believes that section 101(b)(5) is helpful, but not dispositive of the dual qualification issue. Section 101(b)(5) states:

> If any natural gas qualifies under more than one provision of this title providing for any maximum lawful price or for any exemption from such a price with respect to any first sale of such natural gas, the provision which could result in the highest price shall be applicable.

The Commission's proposal in this docket requested "comments on whether conflicts between regulated and deregulated gas prices are governed by this section * * *."

As early as 1979, in comments filed under Docket No. RM79-76, the producers interpreted the language to "compel" deregulation.[14] Producers now contend that section 101(b)(5) only refers to the ability of first sellers to collect the higher regulated prices. However, other commenters argued that the words "the provision which *could* result in

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102(c) or deregulated section 103 gas. An examination of the restrictions applicable to the use of this tax credit belies this interpretation, however.

Congress provided thus:

> (B) Special rules for gas from tight formations—
> The term "gas produced from a tight formation" shall only include—
> (i) Gas the price of which is regulated by the United States, and
> (ii) Gas for which the maximum lawful price applicable under the Natural Gas Policy Act of 1978 is at least 150 percent of the then applicable price under section 103 of such Act.

26 U.S.C. 29(c)(2)(B) [formerly 26 U.S.C. 44(D)(c)(2)(B).]

It is plain that the tax credit option was intended by Congress to be available only so long as the price of the gas "is regulated" [section (B)(i), above). Thus, Congress provided for removal of the tax credit when tight formation gas became deregulated, either as a result of dual classification, or otherwise.

[14] *See* n. 10, *supra*.

the highest price shall be applicable" mean that, if gas is eligible for both regulated and deregulated prices, there always exists at least the potential for the parties to negotiate a contract above the old regulated ceiling price. We agree.

Gas which qualifies for two different ceiling prices, or for a ceiling price and a deregulated price, would qualify for the highest applicable price. In this case, the deregulated price, which always *could* result in a price *higher* than a regulated price, prevails. Although we do not find section 101(b)(5) compelling on this issue, it clearly provides for automatic eligibility for the deregulated price, subject to the agreement of the parties. Much has been said about section 101(b)(5). This statutory section must be understood in the context of the contractual agreements that exist between the parties. However "could" is interpret, it may never operate to nullify the effectiveness of a contractual pricing right that is triggered by statutory deregulation.

3. Producers Claim of Reliance On the Incentive Prices

Some producers claim reliance on the incentive price in section 107(c)(5) and in section 108, and state that the Commission can not arbitrarily deny their ability to collect the incentive price. The Commission believes that this reliance is misplaced. It should have been clearly understood that the incentive price was to be statutorily removed by section 121 for section 102(c) and qualifying section 103 gas.

The Commission response to comments filed by producers in Docket No. RM79-76 put the producers on notice since February, 1980, when the interim rule on tight formations was issued, that tight formation section 107(c)(5) gas would deregulate if the gas also qualified as section 102(c) or section 103 gas. In the 1980 interim rule discussion on deregulation, the following was stated:

> The Commission was interested in soliciting comments as to whether section 101(b)(5) of the NGPA

> requires the eventual deregulation of tight formation gas which also qualifies as section 103 gas the price for which is deregulated in 1985 or 1987 * * *. Those that responded to this request argued that section 101(b)(5) compels deregulation of tight formation gas when that gas is finally determined to qualify under a deregulated category. The Commission agrees and notes with regard to the change in the interim rule that this argument applies equally to new tight formation gas which qualifies under section 102(c).[15]

In light of the above discussion, the Commission believes that the producers' claim of reliance is unsubstantiated.

4. Economic Dislocation

The Commission is not insensitive to the economic dislocation which will be caused by deregulation of gas categories that are dually qualified. However, the mandate of the NGPA is clear. Gas which qualifies for a regulated and deregulated price, deregulates.

The Commission recognizes that deregulation will have an effect on the typical gas sales contract. First, the maximum lawful prices are *ceiling* prices only; contract prices may be lower than the ceiling price. Second, these regulated ceiling rates do not set the *floor* for deregulated prices. Third, many gas sales contracts contain a clause which requires the parties to renegotiate the sales contract if deregulation occurs. These deregulation clauses would allow market forces to reshape the contractual price terms upon deregulation.[16]

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[15] *See* Interim Rule Covering High-Cost Natural Gas from Tight Formations. 45 FR 13414 (Feb. 28, 1980).

[16] *See*, DOE—EIA, Structure and Trends in Natural Gas Wellhead Contracts, November, 1983.

Once deregulation of section 102(c) and qualifying section 103 gas occurs, the contract between the parties must control. Many contract deregulation clauses appear to allow no choice—renegotiation will begin if deregulation occurs. This process is triggered by the *contract* and the NGPA's scheme of deregulation, not by this Commission's policy preferences. The Commission's implementation of the statute is not "forcing" renegotiation: rather, the renegotiation process occurs as a result of the deregulation language in the statute and the parties' own contracts. The Commission's authority to interpret contracts is limited by the decision in *Pennzoil Co.* v. *FERC*.[17] Indeed, section 101(b)(9) sets forth the effect of the contract, regardless of the statutorily imposed maximum lawful ceiling prices or exemptions from ceiling prices, *i.e.*, deregulated prices. In fact, the contract terms prevail. The statute in section 101(b)(9) states that such ceiling prices "shall not supersede or nullify the effectiveness of the price established under such contract."

Thus, any economic harm to producers flows from the NGPA and their contracts. This harm does not flow from this Commission's exercise of discretion in administratively deregulating gas. The Commission has no such authority. In this instance, our mandate is to determine Congress' intent with regard to the dual qualification problem.

5. Gas Qualifying as Section 107 Tight Formation Gas

In order to qualify as new tight-formation gas under section 107(c)(5), a producer must file the same information, in addition to other information, that would be filed

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[17] 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982), "* * * FERC can no longer interpret or apply § 154.93 to these contracts. Whether such a contract authorizes escalation to NGPA prices is for state or federal courts to decide, unless the NGPA vested in FERC independent authority to interpret contracts concerning gas not within FERC's jurisdiction."

to qualify as a section 102 or 103 determination. 18 CFR 274.205(e)(1)(i)(A) or (B) and 271.703(b)(2)(a) (1983). Thus, a determination that gas qualifies as new tight-formation gas is implicitly a determination that the gas meets the qualifications for either section 102(c) or 103. Accordingly, for new tight formation gas for which a producer had received a final determination prior to January 1, 1985, the Commission proposed that such gas would be deregulated under section 121 if the application contained the data and met the requirements for section 102(c) or 103 gas.

Producers argue that tight formation gas is section 107(c)(5) gas, not section 102 or section 103 gas. The Commission does not agree. Such gas is obviously qualified for both categories. Meeting the statutory criteria of section 102 or section 103 is a prerequisite to qualification as new tight formation gas under section 107(c)(5). The Commission thus believes that determinations that gas qualifies under section 107(c)(5) new tight-formation gas should also be considered section 102 or 103 determinations, regardless of whether that was explicit at the time that the determination was made.[18]

D. Deregulation of Intrastate Gas

Section 121(a)(3) deregulates the price of intrastate contracts where the price paid on December 31, 1984, is higher than $1.00 per MMBtu. Section 121(e), however, imposes a new ceiling price[19] on existing or successor contracts but

[18] Gas covered by § 271.703(b)(3), recompletion tight formation gas, does not necessarily qualify under either section 102 or section 103. However, if a recompletion tight formation well, in addition to receiving a section 107(c)(5) determination, also has received either a section 102(c) or the appropriate section 103 determination, it would deregulate on January 1, 1985.

[19] The new ceiling price is established by section 105(b)(3)(B).

not rollover contracts,[20] otherwise deregulated by section 121(a)(3), if the price is established under an indefinite price escalator clause.

This complicated scheme of deregulation raised several issues on which the Commission made proposals, several on how to decide whether gas was priced over $1.00, and several relating to indefinite price escalator clauses.

1. Determining Whether the $1.00 Threshold Is Met

Sections 121 and 105 of the NGPA provide generally that intrastate gas, the price of which is greater than $1.00 per MMBtu on December 31, 1984, is deregulated, provided that the price has not been "established under" an indefinite price escalator clause (as defined in section 105). If the price is greater than $1.00 per MMBtu but is established under an indefinite price escalator, section 105(B)(3) of the NGPA imposes a price limit equivalent to the section 102 ceiling price with a slightly lower adjustment factor, in addition to inflation. In a sense, section 121 deregulates the whole universe of section 105 gas on January 1, 1985, and section 105(b)(3), at the same moment, re-regulates any such gas that was over $1.00 per MMBtu in price on the last day of this year pursuant to an indefinite price escalator (except for gas sold under "rollover" contracts).

The notice of proposed rulemaking (NOPR) stated that the section 121(e) and 105(b)(3)(A) limitation applied only to a situation where operation of an indefinite price escalator was necessary in order to exceed the $1.00 threshold. In a situation where an intrastate contract con-

[20] Various commenters argued that rollover contracts were never "reregulated" by section 121(e), contrary to inferences drawn from the Commission's proposal. The Commission did not intend to imply that rollovers would be reregulated and therefore agrees with these commenters.

tained both a fixed price term and an indefinite price term, and both were over $1.00 per MMBtu on January 1, 1985, the NOPR proposed that the section 105(b)(3)(A) limitation would *not* apply, even if the price on December 31, 1984 was determined pursuant to the indefinite price clause.[21]

Some commenters objected to this interpretation. On the other hand, many commenters supported the position put forth in the NOPR. After careful consideration of the comments on this subject, the Commission has determined to affirm the initial position and rationale on this issue set forth in the NOPR. There is a general lack of discussion in the legislative history on this precise point. However, the language of the statute, and the legislative history that does exist, appears to favor, on balance, the position enunciated in the NOPR. Accordingly, § 271.506(a) is being adopted as proposed.

2. Percentage of Proceeds Sales

A second situation in which it is unclear how to determine if the $1.00 threshold was met arose when the price paid under an intrastate contact is based on a percentage of the proceeds from a subsequent first sale (percentage sale). Determining whether the percentage sale price is above $1.00 per MMBtu on December 31, 1984, obviously presents the problem of determining a specific price paid on December 31, 1984. If conceived of as a daily price, a percentage sale price can fluctuate on a daily basis. For example, under a percentage sale, the price of gas, if reported on a daily basis, may be above $1.00 on December 28, below $1.00 on January 1, 1985, and above $1.00 again on January 3, 1985.

[21] Pursuant to 18 CFR 271.704(a)(3), any amount paid solely by reason of the maximum lawful price provided for production enhancement work shall be disregarded for purposes of applying section 121(a)(3) of the NGPA. This provision still applies.

The Commission faced a similar problem in Order No. 68,[22] in which the Commission had to determine whether a percentage sale exceeded the section 105 and 106(b) ceiling price. The Commission noted that "the pricing mechanisms under sections 105 and 106(b) appear to assume a specific price stipulated by the terms of the contract." That order resolved this dilemma by reference to the subsequent resale between the percentage sale buyer and subsequent purchaser (resale contract). If the resale contract was within the ceiling price authorized by the NGPA, then the Commission assumed that the price paid under the percentage sale was within the ceiling price of the NGPA. The Commission noted that this was "the only practical course."

For purposes of determining whether section 105 gas subject to percentage sales contracts is priced above $1.00 per MMBtu and thereby deregulated, the Commission proposed to follow the same rule established in Order No. 68. As proposed in § 271.506(c), if a resale contract that follows a prior percentage sale is above $1.00 per MMBtu, the Commission would deem the percentage sale deregulated by operation of section 121. Conversely, if the price paid under the resale contract is below $1.00 per MMBtu on December 31, 1984, then the Commission will deem the percentage sale not deregulated by operation of section 121.

All but one commenter on this issue supported the Commission's proposal. Most stated that this approach offered the benefit of administrative simplicity and convenience for all concerned. The objecting commenter (a State agency) stated that it did not believe "sufficient protection" would be afforded by this approach, although it seemed to agree that any impact in the current market appeared "to lack harmful effect."

[22] Rules Generally Applicable to Regulated Sales of Natural Gas and Ceiling Prices, 45 FR 5678 (Jan. 24, 1980) (Order No. 68).

The Commission recognized that under this proposal, there may be certain instances where the price paid under the resale contract is over $1.00 per MMBtu and the percentage given to the seller is less than $1.00 per MMBtu, and thus is not technically eligible for price decontrol. The Commission believes that this problem is *de minimis*. Under section 105, the ceiling price for a percentage resale that remains regulated is the section 102 price ($3.845—December 1984). The Commission believes that, given the current surplus market, there will be few instances in which the price collected for a percentage sale of deregulated gas would exceed or equal the section 102 price. Thus, it makes little practical difference whether the Commission considers these percentage sales regulated or deregulated sales. Also, a decision to deregulate the percentage sale contract will have no rate impact on consumers since the resale contract already qualified for a deregulated price.

The Commission, therefore, will resolve the percentage sale problem as was done in Order No. 68, and proposed in the NOPR.

3. Indefinite Price Escalator Clause Issues

The NGPA at section 105(b)(3)(B) defines the term "indefinite price escalator clause" to include any provision of any contract—

> (i) Which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference to other prices for natural gas, for crude oil, or for refined petroleum products; or
>
> (ii) Which allows for the establishment or adjustment of the price of natural gas delivered under such contract by negotiation between the parties.

15 U.S.C. 3315(b)(3)(B) (1982).

The Commission expects there may be some instances where the parties disagree as to whether a specific clause is an indefinite price escalator clause under this definition.

In the preamble to Order No. 23[23] the Commission gave several examples of clauses in intrastate contracts that fall within the section 105(b)(3)(B) definition of indefinite price escalator clauses—most-favored-nations clauses. price-reference clauses, certain redetermination clauses, FPC clauses, area rate clauses, and other such clauses.[24] The Commission proposed that these clauses are within the definition of indefinite price escalator clauses in section 105(b)(3)(B) and should be used in applying that definition to interstate contracts.

Commenters generally agreed that these types of clauses generally met the section 105(b)(3)(B) definition of indefinite price escalator clause. Commenters argued, however, that although the Commission may define the parameters of what an "indefinite price escalator clause" is for section 105 purposes, it may not address other related questions that are essentially contractual. Such questions are to be left to the State or Federal courts. *See Pennzoil Co.* v. *FERC*, 645 F.2d 360, 382 (5th Cir. 1981).

The Commission here reaffirms its position that the types of clauses found in Order No. 23 to be indefinite price escalator clauses are also indefinite price escalator clauses under section 105(b)(3)(B) and should be so construed in applying the definition to intrastate contracts.

4. Forum for Resolving Disputes Over Indefinite Price Escalations

Disputes over the application of section 105 of the NGPA to particular contractual agreements are necessarily a hybrid. On the one hand, they present statutory inter-

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[23] Final Regulations Amending and Clarifying Regulations Under the Natural Gas Act and the Natural Gas Policy Act, 44 FR 16895, 16898 (Mar. 20, 1979) (Order No. 23).

[24] In Order No. 23, the Commission was concerned with the issue of whether various contractual clauses in interstate contracts provided contractual authority to collect NGPA maximum lawful prices. Here, however, the Commission is concerned not so much with interpreting the intent of parties to contracts but with whether certain pricing clauses fall within the definition of "indefinite price escalator clause."

pretation questions derived from the federal statute. On the other hand, they present questions that are more fundamentally contractual in nature, which are more within the purview of state or federal courts, and not this agency. The line of demarcation separating the former type of questions relating to the specialized statute, and the latter type of questions that are more contractual, is not always clear-cut.

Given that these disputes involve conflict over a term defined in a federal statute and the implementation of the deregulation scheme of section 121, the Commission is convinced that it could exercise exclusive jurisdiction over these disputes if it deemed it necessary. Recognizing, however, that these disputes involve serious questions of contract interpretation between parties residing in the same state, the Commission believes its federal obligation is met by giving the guidance above as to what clauses in intrastate contracts are indefinite price escalator clauses and then allowing further disputes over these clauses to be decided in any appropriate judicial forum.

The notice proposed in § 271.506(a) that the Commission would have exclusive jurisdiction and that a petition for declaratory order "shall" be filed in instances where there is a conflict as to whether a contract clause meets the definition of indefinite price escalator in section 105(b)(3)(B). Many commenters objected to the mandatory nature of this regulation. Commenters were concerned that the potential for contract-by-contract Federal involvement in intrastate contract disputes might ensue, that staff resources might be diverted from the Commission's primary statutory responsibilities into a plethora of contractual issues, and that the jurisdiction of more appropriate forums would be intruded upon. We agree.

Upon consideration, we have determined to delete any references to this Commission's exclusive jurisdiction and the use of a declaratory order. The Commission has

already given guidance as to the types of clauses that fall within the section 105(b)(3)(B) definition. The commenters have convinced us that these disputes are better resolved by judicial forum that is more typically the forum for contract disputes. This decision is further supported by the fact that, by definition, these are contracts involving producers, pipelines, and consumers in the same state. Thus we believe that either state or federal courts should exercise exclusive jurisdiction over these contract disputes.

E. Miscellaneous Issues

The Commission encouraged comments on additional issues in the NOPR and commenters raised many points, several of which require clarification and, in some instances, conforming amendments to the regulations in light of the changes that will be made by the NGPA on January 1, 1985.

1. Section 103, Impact of New Price Ceiling

The ceiling price of tight formation gas, as well as the price of certain production enhancement gas, is keyed to the price of gas under section 103 of the NGPA. The tight formation ceiling price, for example, is 200 percent of the section 103 price, and the formula for determining the price of qualified producton enhancement gas at § 271.704(c)(1)(v) also employs a ceiling calculation based on 200 percent of the section 103 price.

On January 1, 1985, the NGPA provides for a new ceiling price for section 103 gas from wells 5,000 feet or less in depth (for gas which was not committed or dedicated to interstate commerce on April 20, 1977), which is *midway* between the section 102 ceiling price and the "old" section 103 ceiling price. As a consequence, the question arose as to whether to base the tight formation and production enhancement prices on the "new" higher section 103 price after 1984, or to continue using the "old" section 103 price as the price ceiling. Inasmuch as the production enhance-

ment and tight formation prices were established with the intent of using the "old" section 103 price as the reference point, the "old" section 103 price shall continue to be used for this purpose after January 1, 1985. Conforming amendments to the pricing table in the regulations are being made to show both the "old" and "new" section 103 ceiling prices.

2. Section 110 Add-Ons

There was some comment that the Commission should clarify its regulations to indicate that the allowances under section 110 of the NGPA are not available for gas that is deregulated under the NGPA. The Commission believes that the allowances in § 271.1104 for production-related costs should cease to apply to gas that is deregulated on January 1, 1985. Because the price for deregulated gas will be determined by market forces, presumably any production-related costs will be considered in the price ultimately agreed to. Thus, there is no need for a ceiling on the amount a seller can collect for production-related costs for deregulated gas. The Commission believes that this approach is consistent with a decision by Congress to subject a substantial amount of interstate and intrastate gas to market forces after January 1, 1985. It makes little economic sense to keep one component of the price of gas subject to a ceiling while deregulating another component since a seller could legitimately increase the nonregulated components to compensate for cost limitations on the regulated component.

3. Measurement of 5,000 feet and "Committed or Dedicated" Status for Section 103 Purposes

A clarification was requested by some commenters concerning the allocation of production of section 103 gas some of which may be above, and some below 5,000 feet, and some of which may have been committed or dedicated to interstate commerce on April 20, 1977, while some of

which was not. One commenter suggested gas production must be allocated between the regulated and deregulated categories. The Commission generally concurs with this approach. Similarly, where a well is perforated both above and below 5,000 feet, allocation of production would be appropriate if such perforations are in different completion locations. In the case of open hole completions, it also may be appropriate to allocate production to different completion locations.

4. 18 CFR 270.207 and 272.105

On April 22, 1980, the Commission issued a final rule defining and deregulating certain high-cost gas under NGPA sections 107(c)(1)-(4). (Docket No. RM79-44, Order No. 78, 45 FR 18092). One of the Commission's concerns therein was that situations could arise where prices paid for deregulated gas may be paid as consideration for the sale of gas still subject to price regulations, and thus possibly circumventing the applicable maximum lawful prices. To prevent this, §§ 270.207 and 272.105 were promulgated. These regulations prohibit any part of the price paid for deregulated high-cost gas from being used as consideration for regulated gas, and require separate billing for deregulated high-cost gas. Several commenters requested that these sections be amended to include gas that will be deregulated on January 1, 1985. We agree that the price paid for deregulated gas should not reflect an add-on to avoid the ceiling price for other gas sales that remain regulated.

5. Emergency Contract Carriage

A number of commenters suggested that if a seller's first sale volumes are "marketed-out" by a purchaser as a result of deregulation on January 1, 1985, then an emergency contract carriage arrangement would give the seller needed assistance to enable the seller to find alternate markets for its gas. Another commenter noted that the Commission

may not have the authority to accomplish all that has been suggested on this issue. Another commenter asked that the Commission set in motion immediately a rulemaking to establish a contract carriage system.

The Commission has already allowed competitive pressures to operate more freely in the gas marketing network by means of a number of special marketing programs, which are being monitored closely. Whether it is more appropriate to explore contract carriage possibilities in the context of those programs, or elsewhere, is a matter requiring careful assessment to avoid precipitate action and the imposition of any further regulatory distortion in the natural gas markets.

IV. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires certain statements, descriptions, and analyses of rules that will have a "significant economic impact on a substantial number of small entities."[25] The Commission is not required to make such an analysis if it certifies that a rule will not have a "significant economic impact on a substantial number of small entities."[26]

There are approximately 10,000 natural gas producers in the United States, many of which would be classified as small entities under the appropriate RFA definition.[27] In the proposed rule, the Commission noted that the rule might affect most of these entities by amending the filing requirements that must be followed for gas that will be deregulated on January 1, 1985. The Commission stated

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[25] 5 U.S.C. 603(a) (1982).

[26] *Id.* at section 605(b).

[27] *Id.* at section 601(3) *citing to* section 3 of the Small Business Act, 15 U.S.C. 632 (1982). Section 3 of the Small Business Act defines small business concern as a business which is independently owned and operated and which is not dominant in its field of operation.

that, while these changes would be important in implementing deregulation under the Natural Gas Policy Act, the Commission did not believe that the burden imposed by these regulations would be significant. The Commission believed that for the most part, these regulations would merely make legal decisions and technical corrections necessary to implement the statute. In those few instances where the Commission proposed to amend its regulations based on policy, the Commission believed that the economic impact, if any, would not be "significant." Accordingly, the Commission certified the proposed rule, if promulgated, would not have a significant economic impact on substantial number of small entities.

Six commenters challenged this certification. These commenters focused on the Commission's proposed interpretation requiring gas to be deregulated if it qualified for both a regulated and a deregulated category of gas. They argue that they and other small entities would suffer severe economic impacts if the Commission required that they collect a deregulated price for certain section 107 tight formation gas and section 108 stripper well gas that also qualified for a deregulated category (e.g., section 102(c) or section 103(c)). They argue that, given the current surplus market, they would receive a much lower price for this gas if it were considered deregulated.

The Commission believes the certification in the proposed rule was proper. The Commission's proposed rule drew a distinction between rules adopted for policy reasons and rules that embodied legal requirements of the NGPA. The Commission believes that the NGPA itself requires the deregulation of gas qualifying for both a regulated and a deregulated category; this is not a policy decision over which the Commission can be influenced by the economic impact on small businesses.

The Commission believes this distinction is supported by the RFA and its legislative history. Section 2 of the

RFA, stating the purposes of the Act, encourages the consideration of "alternative regulatory approaches which do not conflict with the stated objectives of applicable statutes * * *."[28] Additionally, the Act states that the requirements of the RFA to do a regulatory flexibility analysis "[does] not alter in any manner standards otherwise applicable by law to agency action."[29] Similarly, the Senate Report states that "agencies [should] give explicit consideration to a range of alternatives that would substantially reduce the economic impact of the rule * * * while meeting the goals and purposes of the governing statute."[30] Numerous statements made by Congressmen and Senators at the time of passage of the RFA support the distinction between legal requirements mandated by statute and those adopted as a matter of policy.[31]

As noted above, the Commission believes that Congress intended that gas that qualifies for a deregulated category would be priced according to market forces. While some small producers may suffer severe economic impacts, the Commission believes these impacts are caused by Congress' scheme of deregulation, not by any discretionary policy adopted by this Commission. Accordingly, the Commission continues to believe that it correctly certifed that this rule will not have a significant economic impact on a substantial number of small entities.

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[28] Pub. L. No. 96-354, 94 Stat. 1164 at section 2(a)(7).

[29] 5 U.S.C. 606 (1982).

[30] S. Rep. No. 878, 1980 U.S. Code Cong. & Ad. News 2788.

[31] *See also* 126 Cong. Rec. H. 8463 (daily ed. Sept. 8, 1980) (Statement of Congressman McDade); 126 Cong. Rec. H 8468 (daily ed. Sept. 8, 1980) (Statement of Congressman Andy Ireland) ("Statutory mandates must never be compromised . . . ."); 126 Cong. Reg. H 8472 (daily ed. Sept. 8, 1980) (Statement of Congressman Butler); 126 Cong. Rec. S 10937-38 (daily ed. August 6, 1980) (Statement of Senator Culver) (extensive analysis on "Preserving Statutory Objectives.").

V. Effective date

This rule will become effective on January 1, 1985, to correspond with the date of decontrol under the NGPA.

List of Subjects in 18 CFR Parts 270 through 274

Natural gas, Incentive prices.

In consideration of the foregoing, the Commission amends Parts 270 through 274, Subchapter H, Chapter 1, Title 18 Code of Federal Regulations, as set forth below.

By the Commission.

Kenneth F. Plumb,
Secretary.

PART 270—[AMENDED]

1. The authority citation for Part 270 is revised to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

§ 270.101 [Amended]

2. Section 270.101(a) is amended by removing the words "high-cost" and inserting, in their place, the word "natural."

3. Section 270.101(c)(2) is revised to read as follows:

§ 270.101 Application of ceiling prices to first sales of natural gas.

* * * * *

(c) * * *

(2) The price of gas is deregulated only if such gas is deregulated natural gas as defined in § 272.103(a).

* * * * *

§ 270.102 [Amended]

4. Section 270.102(b)(14) is amended by removing the words "high-cost" and inserting, in its place, the word "natural."

§ 270.207 [Amended]

5. Section 270.207 is amended by removing the word "high-cost" and inserting, in its place, the world "natural" in the title and three times in the text.

6. A new § 270.208 is added to read as follows:

§ 270.208 Applicability of section 121.

First sale of natural gas that is deregulated natural gas as defined in § 272.103(a) is price deregulated and not subject to the maximum lawful prices of the NGPA, regardless of whether the gas also meets the criteria for some other category of gas subject to a maximum lawful price under Subtitle A of Title I of the NGPA.

PART 271—[AMENDED]

7. The authority citation for Part 271 is revised to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

8. The table following § 271.101 is amended by adding a sentence at the end of footnote 1, adding footnotes 4 and 5, revising designation C-103, and adding new designations C-103(b)(2) and E-105(b)(3) in the columns reading "Subpart of Part 271—NGPA Section," to read as follows:

§ 271.101 Ceiling prices for certain categories of natural gas.

* * * * *

TABLE I.—NATURAL GAS CEILING PRICES
(OTHER THAN NGPA SECTION 104 AND 106(a))

Subpart of part 271	NGPA section	Category of gas	Maximum lawful price per MMBtu for deliveries in
B	102	New natural gas, certain OCS gas[4]	.....
C	103(b)(1)	New, onshore production wells[5]	.....
C	105(b)(3)	New, onshore production wells[5]	.....
E	105(b)(3)	Existing intrastate contracts	.....
F			
G			
H			
I			

[1] * * * Commencing January 1, 1985, the price of some intrastate rollover gas is deregulated. (See Part 272 of the Commission's Regulations.)

* * * * *

[4] Commencing January 1, 1985, the price of natural gas finally determined to be new natural gas under section 102(c) is deregulated. (See Part 272 of the Commission's Regulations.)

[5] Commencing January 1, 1985, the price of some natural gas finally determined to be natural gas produced from a new, onshore production well under section 103 is deregulated. (See part 272 of the Commission's Regulations.)

9. Section 271.201(a) is revised to read as follows:

§ 271.201 Applicability.

This subpart implements section 102 of the NGPA and applies to the first sale of:

(a) new natural gas which is not deregulated natural gas (see § 272.103(a)); or

* * * * *

10. Section 271.301 is revised to read as follows:

§ 271.301 Applicability.

This subpart implements section 103 of the NGPA and applies to the first sale of natural gas produced from a new, onshore production well, if such gas is not deregulated natural gas (see § 272.103(a)).

11. Section 271.501 is amended by revising the first sentence to read as follows:

§ 271.501 Applicability.

This subpart implements section 105 of the NGPA and applies to the first sale of natural gas under an existing intrastate contract or under a successor to a intrastate contract, if such natural gas is not deregulated natural gas (see § 272.103(a)). * * *

§ 271.502 [Amended].

12. Section 271.502(a) is amended by removing from the title the words "November 9, 1978, contract price at or below $2.06 per MMBtu."

13. Section 271.502(b) introductory text and (b)(1) are revised to read as follows:

§ 271.502 Maximum lawful prices.

* * * * *

(b) In the case of any first sale of natural gas to which this subpart applies and for which the price paid exceeds $1.00 per MMBtu on December 31, 1984 (or would exceed $1.00 per MMBtu if sold on such date) solely by operation of an indefinite escalator clause, the maximum lawful price for natural gas delivered in any month shall be the higher of:

(1) The maximum lawful price per MMBtu for such month specified for Subpart E of Part 271 in Table I of § 271.101(a); or

* * * * *

14. A new § 271.506 is added to read as follows:

§ 271.506 Rules related to deregulation of intrastate gas.

(a) *Contracts over $1.00 by virtue of a definite price clause.* The price of natural gas subject to this subpart is deregulated if the price paid under a clause other than an indefinite price escalator clause is higher than $1.00 per MMBtu for the last deliveries of such gas occurring on December 31, 1984, or if no deliveries occurred on such date, the price that would have been paid had deliveries occurred on such date.

(c) *Percentage-of-proceeds sales.* The price of natural gas sold under a percentage-of-proceeds contract subject to this subpart is deregulated if the price paid on the resale contract is deregulated under Part 272. (§ 270.202(b) states other rules for percentage-of-proceeds sales.)

15. Section 271.601 is revised to read as follows:

§ 271.601 Applicability.

This subpart implements section 106(b) of the NGPA and applies to the first sale of natural gas under an intrastate rollover contract, if such natural gas is not deregulated natural gas (see § 272.103(a)).

16. Section 271.703(a)(2) is revised to read as follows:

§ 271.703 Tight Formations.

(a) * * *

(2) 200 percent of the maximum lawful price specified for subpart C—NGPA Section 103(b)(1) of Part 271 in Table I for § 271.101(a).

* * * * *

§ 271.704 [Amended]

17. Section 271.704(c)(1)(v) is amended by removing the words "Subpart C" and inserting, in its place, the words "Subpart C—NGPA section 103(b)(1)."

PART 272—[AMENDED]

18. The authority citation for Part 272 reads as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

§§ 272.101 and 272.102 [Amended]

19. Sections 272.101 and 272.102 are amended by removing the words "high-costs" and inserting, in their place, the word "natural."

20. In § 272.103, paragraph (a) is revised to read as follows:

§ 272.103 Definitions.

(a) "Deregulated natural gas" means:

(1) Natural gas for which a jurisdictional agency determination has become final under Parts 274 and 275 that the gas qualifies as:

(i) Deep, high-cost natural gas;

(ii) Gas produced from geopressured brine;

(iii) Occluded natural gas produced from coal seams; or

(iv) Gas produced from Devonian shale.

(2) Natural gas for which a jurisdictional agency determination becomes final under Parts 274 and 275 and which is sold in a first sale on or after January 1, 1985, and such gas qualifies as:

(i) New natural gas as defined in § 271.203;

(ii) Natural gas produced from any new, onshore production well if such gas as defined in § 271.303:

(A) Was not committed or dedicated to interstate commerce (as defined in NGPA section 2(18)) on April 20, 1977; and

(B) Is produced from a completion location which is located at a depth of more than 5,000 feet.

(3) Natural gas sold under an existing intrastate contract, any successor to an existing contract or any rollover contract, if:

(i) Such natural gas was not committed or dedicated to any interstate commerce on November 8, 1978; and

(ii) In the case of any existing or successor contract, the price paid under a clause other than an indefinite price escalator clause for the last deliveries of such natural gas occurring on December 31, 1984, or, if no deliveries occurred on such date, the price that would have been paid had deliveries occurred on such date is higher than $1.00 per MMBtu.

(iii) In the case of any rollover contract, the price paid on December 31, 1984, or if no deliveries occurred on such date, the price that would have been paid had delivery occurred on such date is higher than $1.00 per MMBtu.

* * * * *

21. Section 272.104 is revised to read as follows:

§ 272.104 Special rules for measuring the depth of deregulated natural gas.

For purposes of determining the depth of a completion location under §§ 272.103(a)(2)(ii)(B) and 272.103(b), measurement shall be the true vertical depth from the surface location to the highest perforation point in the completion location.

§ 272.105 [Amended]

22. Section 272.105 is amended by removing the words "high cost" where they occur and inserting, in their place, the word "natural."

PART 273—[AMENDED]

23. The authority citation for Part 273 is revised to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

24. Section 273.202(a)(2) is revised to read as follows:

§ 273.202 Collection pending jurisdictional agency determination of eligibility.

(a) * * *

(2) If an application has been filed with the jurisdictional agency for a determination of eligibility under Part 272 (relating to deregulated natural gas), the deregulated price may be charged pending the jurisdictional agency determination.

* * * * *

25. Section 273.203(a)(2) is revised to read as follows:

§ 273.203 Collection pending review of jurisdictional agency determination.

(a) * * *

(2) If a jurisdictional agency has determined in accordance with Part 274 that natural gas qualifies under Part 272 (relating to deregulated natural gas), the seller may charge and collect the deregulated price during the period described in paragraph (b) of this section.

* * * * *

26. In § 273.204, a new paragraph (a)(1)(iv) is added to read as follows:

§ 273.204 Retroactive collection after final determination.

(a) * * *

(1) * * *

(iv) in the case of a new natural gas (as defined in § 271.203) and natural gas produced from a new, onshore

production well (as defined in § 271.303) which also satisfies the criteria of § 272.103(a)(3), if the application for determination was filed on or before January 1, 1985, then for the first sales of such natural gas delivered on or after January 1, 1985, the seller may retroactively collect the amount by which the deregulated price exceeds the price collected during such period.

* * * * *

§ 273.204 [Amended]

27. Section 273.204(a)(2) is amended by removing the words "Part 272" and inserting, in their place, the words "§ 272.103(a)(1)."

PART 274—[AMENDED]

28. The authority citation for Part 274 is revised to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-34342; Department of Energy Organization Act, 42 U.S.C. 7101-7352.

29. Section 274.101 is amended by revising the introductory language to read as follows:

§ 274.101 Applicability.

This part applies to determinations of jurisdictional agencies (as defined in § 274.501) made under § 272.103(a)(1) and the following subparts of Part 271:

§ 274.104 [Amended]

30. Section 274.104(a) is revised by removing the words "for a maximum lawful price."

APPENDIX F

18 CFR Parts 270, 271, 272, and 273

[Docket No. RM84-14-001, *et al.*, Order No. 406]

Deregulation and Other Pricing Changes on January 1, 1985, Under the Natural Gas Policy Act

Issued: December 21, 1984.

AGENCY: Federal Energy Regulatory Commission.

ACTION: Order denying rehearing in part, granting rehearing in part, denying stay and making technical corrections.

SUMMARY: On November 16, 1984, the Federal Energy Regulatory Commission (Commission) issued a final rule in Docket No. RM84-14-000, Order No. 406, 49 FR 46874 (November 29, 1984), amending its regulations to prepare for price deregulation under section 121 of the National Gas Policy Act for certain types of gas subject to sections 102, 103, 105, and 106, and publishing new maximum lawful prices under sections 103(b) and 105(b)(3). The Commission received 18 timely petitions for rehearing of the final rule in this docket and two late filings that have been treated as petitions for reconsideration. For the reasons detailed in its order, the Commission is denying in part and granting in part rehearing of the final rule and denying stay. This order also makes several technical corrections to the final rule to clarify the regulations.

EFFECTIVE DATE: This order will become effective January 1, 1985.

FOR FURTHER INFORMATION CONTACT:
Peter J. Roidakis (202) 357-8307 or Elizabeth Pendley (202) 357-8476 at the Office of the General Counsel; Federal Energy Regulatory Commission; 825 North Capitol Street, NE., Washington, D.C. 20426.

SUPPLEMENTARY INFORMATION:

Before Commissioners: Raymond J. O'Connor, Chairman; Georgiana Sheldon, A. G. Sousa, Oliver G. Richard III and Charles G. Stalon.

I. Introduction

The Federal Energy Regulatory Commission (Commission) is granting in part and denying in part applications for rehearing of its final rule in Order No. 406,[1] which amended its regulations to prepare for price deregulation under section 121 of the Natural Gas Policy Act of 1978 (NGPA) for certain types of gas subject to NGPA sections 102, 103, 105 and 106. The Commission received timely applications for rehearing of the final rule from eighteen petitioners.[2] For the reasons stated below and those set

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[1] 49 FR 46,874 (Nov. 29, 1984).

[2] Martin Oil Service, Inc., Martin Exploration Management Corporation, Colorado Energy Corporation, RM84-14-001, December 4, 1984; Public Service Commission of the State of New York, RM84-14-002, December 12, 1984; Mitchell Energy Corporation, RM84-14-003, December 14, 1984; Indicated Producers, RM84-14-004, December 14, 1984; Oklahoma Natural Gas Company, a division of ONEOK Inc., RM84-14-005, December 14, 1984; Barrett Energy Company, *et al.* and Calvin Petroleum Corporation, RM84-14-006, December 14, 1984; Louisiana Intrastate Gas Corporation, RM84-14-007, December 14, 1984; Transok, Inc., RM84-14-008, December 14, 1984; Independent Oil and Gas Association of West Virginia, RM84-14-009, December 14, 1984; Independent Oil and Gas Association of New York, RM84-14-010, December 17, 1984; National Fuel Gas Distribution Corporation, RM84-14-011, December 17, 1984; Mr. John H. Hill, RM84-14-012, December 17, 1984; P.S.E.C., Inc., RM84-14-013, December 17, 1984; Pennsylvania Natural Gas Associates, RM84-14-014, December 17, 1984; Damson Oil Corporation and Samson Resources Company, RM84-14-015, December 17, 1984; Amoco Production Company, RM84-14-016, December 17, 1984; Conoco Inc., RM84-14-017, December 17, 1984; Ohio Oil and Gas Association, RM84-14-018, December 17, 1984.

forth in the final rule, this order grants rehearing in part, denies rehearing in part, and denies applications for stay.[3]

II. Background

On January 1, 1985, NGPA section 121 will deregulate the prices for substantial amounts of intrastate and interstate gas. Section 121(a) eliminates price controls from "new natural gas" defined in section 102(c)[4] and certain gas produced from "new, onshore production wells" under section 103.[5] Except for gas that is subject to section

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The Commission also received a petition for reconsideration from Louisiana Resources Corporation, RM84-14-020, December 18, 1984 and an untimely filed petition for rehearing from the Pennsylvania Oil and Gas Association (POGAM), RM84-14-019, December 18, 1984. The Commission will consider POGAM's petition as a petition for reconsideration rather than a petition for rehearing.

[3] Two petitioners requested stay of Order No. 406 pending consideration of the rehearing petitions and possible court review. The Commission denies the requests for stay as not in the public interest. Deregulation will occur on January 1, 1985. Rules for orderly transition are necessary; Order No. 406 promulgates these rules. Therefore, it is not in the public interest to grant a stay of these rules.

[4] "New natural gas" under section 102(c) covers three types of gas: (1) gas produced from the Outer Continental Shelf under a lease entered into, on or after April 20, 1977; (2) gas produced from an onshore well on which surface drilling began on or after February 19, 1977, or the depth was increased by 1,000 feet on or after that date, and which is at least 2.5 miles from the nearest marker well or which is 1,000 feet deeper than the deepest completion location of any marker well within 2.5 miles; and (3) gas produced from a reservoir from which natural gas was not produced in commercial quantities before April 20, 1977, subject to certain exclusions.

[5] "New onshore production wells" under section 103(c) are onshore wells on which surface drilling began on or after February 19, 1977, and from which gas is produced from a proration unit that meets certain requirements. Section 121 deregulates on January 1, 1985, the price of gas produced from section 103 wells where the gas was not committed or dedicated to interstate commerce on April 20, 1977, and is produced from a completion location deeper than 5,000 feet.

121(e), section 121 also deregulates the price of intrastate gas that is categorized as section 105 or 106(b) gas, if the price paid for the last deliveries of such natural gas occurring on December 31, 1984 (or, if no actual deliveries occurred on that date on December 31, 1984, the price that would have been paid for deliveries) is higher than $1.00 per MMBtu.[6]

In general, the Commission's final rule stated (1) that jurisdictional agency determinations are still necessary for section 102 and section 103 gas after January 1, 1985; (2) that first sellers may make interim collections at the agreed upon deregulated price; (3) that gas which qualifies for both a regulated and a deregulated category will be deregulated; (4) that contract prices for intrastate contracts above $1.00 per MMBtu by virtue of a definite price clause[] would not be subject to the limitation imposed by section 121(e).

Rehearing was requested on two primary issues: (A) whether gas which qualifies for a regulated and a deregulated category will deregulate on January 1, 1985; and (B) whether certain intrastate gas will be deregulated.

III. Disposition of Applications for Rehearing

A. Dual Qualification Gas

In the final rule on deregulation of certain NGPA gas categories, the Commission stated that gas which qualified for a regulated and a deregulated category will be deregulated.[7]

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[6] *See* 15 U.S.C. 3331(e) (1982).

[7] Some examples of dually qualified gas—one regulated under a maximum lawful price and one which will be deregulated on January 1, 1985 are—(1) new tight formation gas (section 107(c)(5)) which also qualifies under section 102(c) or qualifying section 103 in order to receive the section 107(c)(5) incentive price; (2) some stripper well gas (section 108) which also has determinations as section 102(c), or section 103 which qualifies for deregulation or section 105 deregulated gas.

Fourteen petitioners requested rehearing on this issue, stating that the decision on dually qualified gas in the final rule did not accurately mirror Congressional intent, was unlawful or arbitrary, and would lead to unintended results in the marketplace. These objections were addressed in the final rule. For the reasons listed in the final rule and reemphasized here, the applications for rehearing on this issue are denied.

(1) Section 121 Mandates Deregulation

The Commission recognizes that Congress had two major objectives in mind when it passed the NGPA in 1978. First, in the short term, it maintained a regulatory structure of price controls and, within that structure, provided incentives to encourage exploration and development of new reserves and, second, in the long term, it gradually substituted market forces for regulated prices by phasing in deregulation in 1985 and 1987. Petitioners believe that the Commission's determination for dealing with dually qualified gas creates a conflict between these two objectives. The Commission disagrees. The deregulation of certain categories of natural gas as provided in the NGPA is not in conflict with the goal of increasing energy supplies. Indeed, deregulation fosters this goal. Without question, phased deregulation was one of the primary methods utilized by Congress to increase energy supplies.[8]

[8] *See* Cong. Rec. S15219 (September 15, 1978), in which Senator Bartlett introduced a letter written by President Jimmy Carter to the Governor of Oklahoma; "The decontrol of producers' prices for new natural gas would provide an incentive for new exploration and would help our nation's oil and gas operators attract needed capital. Deregulation of new gas would encourage sales in the interstate market and help lessen the prospect of shortages in the nonproducing states which rely on interstate supplies. While encouraging new production, this proposal will protect the consumer against sudden sharp increases in the average price of natural gas."

The statute clearly states that price controls for certain section 102(c), qualifying section 103(c) and section 105 gas "shall * * * cease to apply January 1, 1985." NGPA section 121 mandates deregulation for these categories of gas. The fact that some of this gas also qualifies for another gas category does not alter this Congressional mandate to deregulate. The Commission is well aware that the NGPA does not deregulate section 107(c)(5) gas[9] or section 108 gas; the NGPA does, however, deregulate gas under either of those categories which also qualifies for a category which is deregulated on January 1, 1985. In support of the Commission's position, in the September 25, 1978 Senate floor debate, it was stated that stripper wells are deregulated:

> only to the extent that such wells are otherwise new wells and would be deregulated any way. Their character as stripper wells, as shown under section 121 does not get them deregulated in any way.[10]

As noted in the final rule, Congress recognized that gas could simultaneously receive a dual qualification, one for when the gas is regulated, *i.e.*, a stripper well qualification, and one for when the gas will be deregulated, *i.e.*, a section 102(c) new gas determination.[11] By permitting the determination process to qualify the same gas for regulated and deregulated categories at the same time, the path was streamlined for deregulation on January 1, 1985. This gas is *dually* qualified; each determination is necessary for a specific period of time. The Commission believes that one determination for the regulated category could govern until January 1, 1985, and then the determination for the deregulated category could take effect.

[9] Approximately 40% of new tight formation wells will not be deregulated because they are above the 5000 foot depth requirement for section 103 deregulation.

[10] Cong. Rec. S15997 (September 25, 1978).

[11] Cong. Rec. H13115-17 (October 14, 1978).

Additionally, section 121 contains exclusions from deregulation for Alaskan natural gas and for intrastate gas priced under indefinite price escalators. It does not, however, include an exemption for dually qualified gas. It does not include an exemption where a lower deregulated market price was unanticipated in 1978. It does not include an exemption allowing the parties to choose to remain regulated. Considering the Congressional intent to deregulate natural gas, and its failure to articulate a specific statutory exemption for dually qualified gas, the Commission has concluded in Order No. 406 that gas that is dually qualified is deregulated on January 1, 1985. The Commission affirms that determination.

(2) Section 101(b)(5)

Section 101(b)(5) states: "If any natural gas qualifies under more than one provision of this title providing for any maximum lawful price or for any exemption from such a price with respect to any first sale of such natural gas, the provision which could result in the highest price shall be applicable."

Petitioners assert that section 101(b)(5) permits them to choose a regulated price for dually qualified gas, their contract provided if they receive a higher price for regulated gas than for deregulated gas. The Commission disagrees with this statutory interpretation.

Section 121 states that the "provisions of subtitle A respecting the maximum lawful prices" for the first sale of section 102, section 103 and section 105 cease to apply, effective January 1, 1985. Various commenters to the Commission's proposed rule concluded that section 101(b)(5) no longer applies once deregulation occurs since section 101 is a "provision of subtitle A" that would "cease to apply" to deregulated gas. Several commenters also state that deregulated gas was not covered by section 101(b)(5) since such gas was not an "exemption from such" maximum

lawful price. These commenters argue that "exemption" does not refer to deregulated gas. To bolster this position the commenters refer to a statement made by Congressman Dingell in referring to section 101(b)(5) that "this rule is intended to facilitate resolution of which *ceiling price* may apply if more than one ceiling price rule appears applicable." (emphasis added).[12] Thus, these commenters argue that the Dingell statement makes it clear that producer choice exists with regard to two regulated ceiling prices and not to a choice between a regulated and a deregulated price.

The Commission recognizes that there may be some merit to these arguments. However, even if section 101(b)(5) does in fact apply to deregulated gas, the Commission believes that the statutory language compels the gas to be sold at a deregulated price. The language of section 101(b)(5) states that the producer may choose the NGPA category which "could result in the highest price." Without question, a deregulated price *could* always result in a price higher than a regulated price which is subject to a ceiling price; whether the *contract* allows the producer to collect a price higher than a regulated price is a contractual issue, not an issue raised by the deregulation scheme of the NGPA.[13]

Therefore, the Commission states that section 121 is self-executing. Price deregulation occurs by operation of law. There is no statutory allowance for the producer or the purchaser to choose whether or not to deregulate gas that qualifies under section 121 for deregulation.

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[12] *See* 124 Cong. Rec. H 13116 (October 14, 1978).

[13] *See* H.R. Rep. No. 1752, 95th Cong., 2nd Sess. 75 (1978) in which the Conference Report states that section 101(b)(5) "provides that if natural gas qualifies under more than one price category, the provisions that permit the seller to obtain the highest price applies."

(3) Claims of Reliance

Petitioners claim that they relied to their detriment on the continued availability of the incentive price in section 107(c)(5) and in section 108 by making investments they would not otherwise have made. They allege that the Commission may not arbitrarily limit their ability to collect the incentive price.

Upon enactment by Congress of the NGPA on November 9, 1978, producers were aware that section 121 required deregulation of section 102, qualifying section 103 and section 105 gas. The impending deregulation of these sections should not suprise producers.

Initially, the Commission cites the statement by Congressman Dingell who, when discussing the meaning of dual qualification, stated, "A single proceeding to determine qualification for both designations (new natural gas and stripper well gas) would permit the producer to obtain stripper well pricing under section 108 prior to January 1, 1985, and deregulation as new gas thereafter." [14] Thus, producers should have known that certain dually qualified gas would be deregulated by the NGPA on January 1, 1985.

Furthermore, producers recognized that the new tight formation gas incentive price was an interim measure which would be discard once deregulation occurs, and stated this position as early as 1979 in filed comments on the tight formation rulemaking.[15] The Commission stated this position in the preamble to the tight formations rulemaking.[16] The Commission believes that producers were in fact aware of the limited time during which incentive prices would be available, if related to categories of gas

[14] *See* Cong. Rec. H 13116-17, October 14, 1978.

[15] *See* Order No. 406, 49 FR 46,878 (Nov. 29, 1984).

[16] Interim Rule Covering High-Cost Natural Gas from Tight Formations, 45 FR 13,414 (Feb. 28, 1980).

which will be deregulated.[17] Faced now with a different economic climate upon deregulation than previously anticipated, they cannot reasonably assert reliance on the continuance of incentive prices when coupled with categories of gas which will be deregulated.

The Commission noted in the final rule and asserts here that producers had no reason to rely on the continuation of regulated price categories which were linked with categories which will deregulate on January 1, 1985. The Commission believes these claims cannot be sustained.

(4) Economic Dislocation and the Gas Sales Contract

Petitioners again claim that the loss of incentive prices will cause insurmountable economic dislocation.[18]

[17] Several petitioners argue that these comments were made to the Commission's request for comments on the issue of whether new tight formation gas would deregulate if the deregulated price were higher than the incentive price. While these comments respond in the context of a different economic climate than was anticipated by them, the Commission, and, apparently, the Congress, the Commission notes that the legal result is the same. The Commission raised these comments to the tight formation rule not as support for its legal result but rather to rebut producers' current claim that they were unaware that deregulation might have an impact on tight formation gas.

[18] On a related issue, the Commission in Order No. 406 stated that it had properly certified under the Regulatory Flexibility Act (RFA), 5 U.S.C. 605(b) (1982), that the Commission's rule would not have a "significant economic impact on a substantial number of small entities." 49 Fed. Reg. at 46882-83 (Nov. 29, 1984). The Commission further noted that the economic impact caused by the deregulation of dually qualified gas is the direct result of the NGPA, not from the final rule.

One petitioner argued that the Commission has improperly interpreted the NGPA, that the Commission's final rule will cause small entities to suffer significant economic impacts, and that the Commission should, therefore, issue a final regulatory flexibility analysis required by the RFA. This petitioner's argument rests on an incorrect interpretation of the NGPA and the belief that the Commission's rule causes them economic harm. The Commission believes that any

The Commission recognizes the difficulties which may occur in adjusting to market level prices. However, the mandate of the NGPA is clear. Gas which qualifies for both a regulated and deregulated price is deregulated.

Furthermore, as was noted in the final rule, it is not the Commission which is forcing deregulation. Rather, it is the statutory language of the NGPA and the contract deregulation clauses which trigger renegotiation once deregulation occurs. Once deregultaion occurs, the contract between the parties must control and the contract terms prevail.[19] Thus, as the Commission stated in the final rule, any economic harm to producers results from the NGPA and their contracts, not from this Commission's exercise of its administrative authority to implement the NGPA. The Commission's mandate is to implement Congress' intent with regard to dual qualification gas.

(5) Section 107(c)(5) New Tight Formation Gas

Petitioners state that certain tight formation gas is only section 107(c)(5) gas and is not dual qualification gas be-

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economic harm suffered by producers is caused by the NGPA, current economic conditions, and their contracts. Such economic impacts are not, for reasons stated in the final rule, cognizable under the RFA unless the agency has some discretion in tailoring its rules tc minimize such impacts. The Commission, therefore, continues to believe that it property certified that its rule, as opposed to the NGPA, will not have a "significant economic impact on a substantial number of small entities."

[19] The Commission agrees with one petitioner who suggested that upon deregulation contractual provisions could determine the price to be paid for deregulated gas by reference to a regulated maximum lawful price, whether directly or indirectly by operation of an area rate clause, favored nations clause, or other pricing provision. The Commission agrees that the seller may refer to a maximum lawful price in order to price deregulated gas, but that reference does not make the gas "regulated" gas. The NGPA regulated price used as a reference price thereby becomes the contract price.

cause in some instances it has not been determined to be section 102 or section 103 gas. They therefore claim that the Commission is deregulating a single-category of gas which the NGPA does not deregulate.

This is not so. In order to qualify as new tight-formation gas under section 107(c)(5), the gas must meet section 102 or section 103 qualification requirements as a threshold to obtaining a section 107(c)(5) determination. The Commission's regulations leave no doubt that gas must first be section 102 or section 103 gas before qualifying as new tight formation gas under section 107(c)(5) gas. Specifically, the regulations state

> new tight formation gas *is* natural gas: which *is new natural gas,* [as defined in section 102(c)), certain OCS gas qualifying for the new natural gas ceiling price (as defined in section 102(d)), or *gas produced through a new onshore production well* [as defined in section 103(c)). (Emphasis added.[20])

If the section 102(c) or 103 qualification requirements were not met, a section 107(c)(5) determination would not be granted. Indeed, producers who received tight formation determinations without meeting the threshold requirements of section 102(c) or section 103 would be in violation of the Commission's regulations. If this occurred, the Commission would toll its 45-day review period until the discrepancy in the determination was resolved. Many jurisdictional agencies require the producer to style a section 107(c)(5) application as both a section 102(c) or section 103(c) and a section 107(c)(5) determination.[21] The jurisdictional agencies, however, grant a

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[20] *See* 18 CFR 271.703(b)(3)(i) (1983) and 18 CFR 274.205(e)(1)(i)(A) or (B) (1983).

[21] Texas, Pennsylvania, Louisiana, Oklahoma, Virginia and Kentucky issue formal dual determinations. Approximately 10,000 of these tight formation determinations for section 102(c) wells or for section 103 wells at a depth of at least 5,000 feet have been made (approximately 40% of all section 107(c)(5) filings).

section 107(c)(5) determination regardless of whether in form it is styled as a section 102(c) or 103 determination, because they must first reach the conclusion that the well qualifies as a section 102(c) or section 103 in order to grant new tight formation status.[22] Regardless of the formal requirements required by jurisdictional agencies, such gas is dually qualified, because a section 107(c)(5) new tight formation determination is a section 102(c) or section 103 determination. With the threshold regulatory requirements met, the gas qualifies for deregulation on January 1, 1985.

B. Deregulation of Intrastate Gas

Petitioners raise two issues regarding deregulation of certain intrastate gas. First, petitioners request that the Commission clarify how intrastate gas is deregulated by section 121(a)(3). Second, petitioners request that the Commission change its position on the effect of the section 121(e) limitation on certain contract clauses.

(1) Determining Whether Intrastate Gas Is Deregulated Under § 121(a)(3)

Several petitioners asked the Commission to clarify an ambiguity between the preamble to the final rule and the regulatory text adopted by the Commission. These petitioners indicated that the Commission's preamble suggested that all intrastate gas subject to existing, successor, and rollover contracts would be deregulated if the price is over $1.00 per MMBtu. The Commission's regulations (18

[22] Approximately 2,100 tight formation determinations have been made (approximately 10% of all new section 107(c)(5) filings for section 102(c) wells or for section 103 wells completed at a depth greater than 5,000 feet) in which the states do not formally require that it be styled a section 107(c)(5), new tight formation and a section 102(c) or section 103 application.

CFR 271.502(b), 271.506(a), and 272.103(a)(3)(ii)), however, can perhaps be read to mean that such gas is deregulated only if the price is over $1.00 per MMBtu as a result of a definite price clause.

The Commission will amend its regulations to rectify any perceived ambiguity and make clear the NGPA's deregulation scheme for intrastate gas is subject to existing, successor, and rollover contracts. Under NGPA section 121(a)(3), all gas subject to existing, successor, or rollover contracts is deregulated if "the price paid * * * on December 31, 1984, * * * is higher than $1.00 per MMBtu." Thus, all such gas is deregulated if the price is over $1.00 per MMBtu. It makes no difference whether the gas is priced under a definite price clause or an indefinite price escalator clause. If the price is over $1.00, it is deregulated under section 121(a)(3). The operation of indefinite price escalation clauses in contracts governing such deregulated gas is, however, subject to the limitation imposed by section 121(e).[23] The Commission nevertheless wishes to emphasize that, under section 121(a)(3), intrastate gas is deregulated if its price on December 31, 1984, *under any pricing clause or combination of clauses*, is over $1.00 per MMBtu. Accordingly, the Commission is amending § 271.502(b) and § 272.103(a)(3)(ii).

[23] Various commenters to the proposed rule and petitioners on rehearing attach significance to whether this price cap is characterized as "continuing regulation," "deregulation and reregulation," or "not regulation but a limitation on certain contract clauses." The NGPA is clear that section 121(e) does not impose a form of continuing regulation of first sales of section 105 gas *per se*, but merely limits the operation of particular contractual provisions. The effects, if any, of this NGPA provision on particular contracts may, of course, result in contractual disagreements. The Commission declines to resolve such disputes in a generic context.

(2) Determining the Effect of Section 121(e) and Section 105(b)(3)(A) on Certain Price Escalator Provisions

Order No. 406 provided that "where an intrastate contract contained both a fixed price term and an indefinite price term, and both were over $1.00 per MMBtu * * * the section 105(b)(3)(A) limitation would *not* apply," even if the December 31, 1984, price was actually computed under the indefinite price clause.

Six petitioners object to the Commission's interpretation. Upon consideration of these petitioners' arguments, the Commission has determined to grant rehearing on this issue, as requested by these petitioners.

Several examples will clarify the different results that would obtain under the approach adopted in Order No. 406 and the petitioners' approach adopted herein.

Example 1: The price under the definite price clause is 75¢ and under the indefinite price escalator clause is $4.50.

Example 2: The price under the definite price clause is $1.25 and under the indefinite price escalator clause is $4.50.

Example 3: The price under the definite price clause is $4.25 and under the indefinite price escalator clause is $5.00.

In all three examples, assume that section 121(e) and 105(b)(3)(A) limit indefinite price escalator provisions in the affected contracts from exceeding $4.00,[24] that the

[24] The price cap imposed by section 121(e) is calculated using a formula found in section 105(b)(3)(A). The cap is the higher of the contract price on the date of enactment of the NGPA, adjusted for inflation, or the section 102 price with an inflation and growth adjustment. The $4.00 price cap in the hypothetical above assumes that $4.00 is the higher of either of these two alternatives.

gas in all of the examples is otherwise deregulated under section 121(a)(3), and the gas is not sold under a rollover contract.[25]

Under the Commission's Order No. 406, only gas in Example 1 would be subject to the price cap and the producer could collect only $4.00. This is so because the price escalator clause increased the price of gas to above the $1.00 threshold to be deregulated. That is, the cap only applied if the indefinite clause was necessarily used to deregulate the gas. In Examples 2 and 3, the price cap would not be applicable under the final rule's approach because the gas would have been deregulated if it were priced under the definite clause, (whether it was in fact priced under the definite price clause was irrelevant).

Under the approach urged by the petitioners and now adopted by the Commission, the price computed under the indefinite price escalator clause would be limited to $4.00 in both Examples 1 and 2 because in these examples the gas is sold at a "price established under an indefinite price escalator clause." It would be irrelevant which clause caused the gas to go above the $1.00 threshold; it would only be relevant to determine if the intrastate gas otherwise deregulated is priced under an indefinite price clause.

The Commission notes that in Example 3 the gas could be sold for $4.25, that is, not subject to the section 121(e) limitation, since the price is established under a definite clause, not an indefinite clause. The limitation in section 121(e) is a limitation only on the operation of *indefinite* price escalator clauses in an existing or successor to an existing intrastate contract, not a limitation on the operation of definite escalator clauses. Moreover, there is no limitation imposed by the NGPA on the parties to a deregulated intrastate contract agreeing to a definite price which is in

[25] Indefinite price escalator clauses in contracts for rollover gas are never subject to the limitation imposed by section 121(e).

excess of the limitation on *indefinite* escalators under section 121(e).[26] The only limitation imposed by section 121(e) is on the operation of indefinite price escalator clauses in contracts for certain deregulated intrastate gas. If, however, the producer in Example 3 prices the gas under the indefinite clause at $5.00, then the limitation would apply and the gas could not be sold above $4.00.

The arguments marshalled by the six petitioners on rehearing have persuaded the Commission that the section 121(e) limitation on indefinite price escalator clauses was intended to be more broadly applicable than had been originally construed in Order No. 406.

Petitioners generally assert that under NGPA section 121(e) the limitation on indefinite escalator clauses is applicable commencing January 1, 1985, to gas otherwise deregulated by section 121(a)(3) whenever the price paid is established under an indefinite escalator clause in the contract. The petitioners assert that such gas is being sold at a price "established under" an indefinite price escalator clause for purposes of the section 121(e) limitation.

Petitioners point out that the Conference Committee Report indicates that the section 121(e) limitation applies to indefinite price escalator provisions in *all* existing and successor contracts for intrastate gas which is deregulated under section 121(a). The Conference Report states:

> This special rule [in section 121(e)] limits the operation of indefinite price escalator clauses in existing intrastate contracts for which the contract price on

[26] Section 105(b)(3)(C) prohibiting contract modifications in certain intrastate contracts does not prevent parties to an intrastate contract from renegotiating a price higher than the section 105(b)(3)(B) limitation if the price is determined under a *definite* price clause. Section 121(e) makes section 105(b)(3) applicable only if gas is sold under a price established under an *indefinite* price escalator clause. Thus, if the parties renegotiate the contract and price the gas under a definite price clause, section 121(e) would never trigger the section 105(b)(3) limitation on indefinite price clauses.

> December 31, 1984 is higher than $1.00 per MMBtu's so that the contract price may not exceed the new gas ceiling price as of January 1, 1985, adjusted by the monthly equivalent of the annual inflation adjustment factor, plus 3.0 percentage points. This limitation applies to natural gas which is deregulated solely as a result of qualifying as an existing contract or a successor to an existing contract in excess of $1.00 per million Btu's on or before December 31, 1984.

H. Rep. 95-1752, at 83 (1978).

Petitioners also draw support in the September 8, 1978, letter from Charles B. Curtis, then Chairman of the Commission, to the Honorable Henry M. Jackson. The letter states that "section 105(b)(3) defines the pricing policy to be effective in January, 1985 where the contract price as defined in section 105(c) is increased as a result of an indefinite price escalator clause." Finally, the statement of the floor manager of the NGPA, Congressman Dingell, that:

> [t]he conferees were concerned that, following deregulation, the operation of indefinite price escalator clauses in existence on May 3, 1978, and contained in certain existing intrastate contracts, could operate to increase rapidly intrastate gas prices following deregulation [and that] section 105(b)(3)(A) puts a lid on that escalation.[27]

serves to buttress further the petitioners' postion.

Accordingly, the Commission has granted petitioners' request for rehearing on this issue, and has made conforming technical amendments, including deleting § 271.506(a) from the regulations. Thus, the section 121(e) and section 105(b)(3)(A) limitation applies to any indefinite price escalator clause in an existing or successor intrastate contract that is, or would have been in excess of $1.00 per MMBtu on December 31, 1984.

[27] 124 Cong. Rec. H. 13117-18 (October 14, 1978).

C. Other Issues

Certain other issues were raised and certain technical and conforming amendments need to be made in the final rule. These other issues and corrections follow:

(1) Interim Collections

One petitioner requested that the Commission clarify its intent with regard to the negotiation of an interim rate. The final rule provides that:

> an agreed-upon rate will govern interim collections. However, if the parties are entitled to renegotiate the price upon deregulation, they need do so only once. The agreed-upon interim deregulated price may continue to serve as the deregulated price, once the gas is ultimately determined to be deregulated.

49 FR 46877 (Nov. 29, 1984).

In response to the petitioner's request, the Commission clarifies that the agreed-upon interim rate may be established by whatever means is agreeable to the parties. The Commission does not intend to interfere with contract rights applicable to deregulated gas. *See generally Pennzoil Co.* v. *FERC*, 654 F.2d 360, 375 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982). Accordingly, the Commission acknowledges that the deregulated rate collected as an interim payment may be established without renegotiation of some separate and interim rate where contract authority governing interim collection upon deregulation is in place.

(2) Affidavit for Section 103 Dedication and Depth Requirement

One petition requested clarification of the suggestion made by the Commission that producers provide pipelines with an affidavit, upon request, that certain gas meets the dedication and depth requirements of NGPA section 121(a)(2) for certain section 103 gas. *See* 49 FR 46877 (Nov. 29, 1984). The petitioner's concern is that some pipeline purchasers may use the affidavit requirement in order to delay payment of the deregulated price.

The Commission believes that in many cases the pipeline will already possess the needed information on the dedication and depth of the section 103 well. In those cases where the pipeline does not already possess the needed information, the simple affidavit procedure serves a useful purpose. The Commission does not wish this procedure to be used as a vehicle to delay payment, however. The Commission therefore grants the clarification requested that the pipeline should not delay payment of the deregulated price until the affidavit is received. If it is subsequently determined that the gas that is the subject of the affidavit is not deregulated, the producer would, of course, be required to refund the difference between the deregulated price and the otherwise applicable maximum lawful price with interest.

(3) Technical Corrections

The Commission is making several minor technical corrections either to improve the clarity of its regulations, to correct inaccurate cross-references, or to make the regulations conform to other changes in the Commission's regulations being made on rehearing.

List of Subjects in 18 CFR Parts 270 through 273

Natural gas, Incentive prices.

In consideration of the foregoing as well as the reasons set forth in the final rule of this docket, the Commission amends Parts 270 through 273, Chapter 1, Title 18, Code of Federal Regulations, as set forth below.

By the Commission.

Kenneth F. Plumb,
Secretary.

PART 270 – [AMENDED]

1. The authority citation for Part 270 continues to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

In § 270.202, paragraph (h) is revised to read as follows:

§ 270.202 Resales.

* * * * *

(h) *Special rules for percentage-of-proceed sales.*

(1) In the case of natural gas purchased by a reseller in a percentage-of-proceeds sale, the reseller may determine the maximum lawful price for the resale under paragraph (a)(1) of this section. If the reseller so determines his maximum lawful price, any sale to such reseller in such percentage-of-proceeds sale shall not be treated as a first sale for purpose of this subchapter.

(2) The price of natural gas sold under a percentage-of-proceeds contract subject to subparts E and F of Part 271 is deregulated if the price paid on the resale contract is deregulated under Part 272.

PART 271 – [AMENDED]

3. The authority citation for Part 271 continues to read a follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

4. In § 271.502, paragraph (b) is revised to read as follows:

§ 271.502 Maximum lawful prices.

* * * * *

(b) The maximum lawful price per MMBtu for natural gas delivered in any month which is:

(1) gas to which the subpart applies;

(2) gas for which the price paid exceeds $1.00 per MMBtu on December 31, 1984 (or would exceed $1.00 per MMBtu if sold on such date); and

(3) gas which is sold at a price established under an indefinite price escalator clause as defined in section 105(b)(3)(B) of the NGPA;

shall be the higher of the price specified for Subpart E of Part 271 in Table I of section 271.101(a) or the contract price per MMBtu on November 9, 1978, adjusted for inflation in accordance with § 271.102 of this part.

§ 271.506 [Removed]

5. Section 271.506 is removed.

PART 272 – [AMENDED]

6. The authority citation for Part 272 continues to read as follows:

Authority: Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432.

7. In § 272.103, paragraphs (a)(3) and (a)(3)(ii) are revised to read as follows:

§ 272.103 Definitions.

(a) * * *

(3) Natural gas sold under an existing intrastate contract, any successor to an existing intrastate contract, or any intrastate rollover contract, if:

(i) * * *

(ii) in the case of any existing or successor intrastate contract,

(A) the price paid for the last deliveries of such natural gas occurring on December 31, 1984, or, if no deliveries occurred on such date, the price that would have been paid if deliveries occurred on such date is higher than $1.00 per MMBtu, and

(B) such gas is not subject to the maximum lawful price in section 271.502(b); or

(iii) * * *

PART 273—[AMENDED]

5. Section 273.204(a)(1)(iv) is amended by removing the words "§ 272.103(a)(3)" and inserting, in their place, the words "§ 272.103(a)(2)(ii)."

APPENDIX G

Section 101(b)(5) of the Natural Gas Policy Act of 1978, 15 U.S.C. 3311(b)(5), provides:

(b) Rules of general application

* * * * *

(5) Sales qualifying under more than one provision

If any natural gas qualifies under more than one provision of this title providing for any maximum lawful price or for any exemption from such a price with respect to any first sale of such natural gas, the provision which could result in the highest price shall be applicable.

Section 107(c)(5) of the Natural Gas Policy Act of 1978, 15 U.S.C. 3317(c)(5), provides:

(c) *Definition of high-cost natural gas*

For purposes of this section, the term "high-cost natural gas" means natural gas determined in accordance with section 503 of this title [15 U.S.C. 3413] to be—

* * * * *

(5) produced under such other conditions as the Commission determines to present extraordinary risks or costs.

Sections 121 and 122 of the Natural Gas Policy Act of 1978, 15 U.S.C. 3331 and 3332, provide:

SEC. 121 [15 U.S.C. 3331]. ELIMINATION OF PRICE CONTROLS FOR CERTAIN NATURAL GAS SALES

(a) GENERAL RULE.—Subject to the reimposition of price controls as provided in section 122 [15 U.S.C. 3332], the provisions of subtitle A respecting the maximum lawful price for the first sale of each of the following categories of natural gas shall, except as provided in subsections (d) and (e), cease to apply effective January 1, 1985:

(1) NEW NATURAL GAS.—New natural gas (as defined in section 102(c) [15 U.S.C. 3312]).

(2) NEW, ONSHORE PRODUCTION WELLS.—Natural gas produced from any new, onshore production well (as defined in section 103(c) [15 U.S.C. 3313]), if such natural gas—

(A) was not committed or dedicated to interstate commerce on April 20, 1977; and

(B) is produced from a completion location which is located at a depth of more than 5,000 feet.

(3) INTRASTATE CONTRACTS IN EXCESS OF $1.00.—Natural gas sold under an existing contract, any successor to an existing contract, or any rollover contract, if—

(A) such natural gas was not committed or dedicated to interstate commerce on the day before the date of the enactment of this Act; and

(B) the price paid for the last deliveries of such natural gas occurring on December 31, 1984, or, if no deliveries occurred on such date, the price would have been paid had deliveries occurred on such date is higher than $1.00 per million Btu's.

(b) HIGH-COST NATURAL GAS.—Effective beginning on the effective date of the incremental pricing rule required under section 201 [15 U.S.C. 3341], the provisions of subtitle A respecting the maximum lawful price for the first sale of natural gas shall cease to apply to the first sale of high-cost natural gas which is described in section 107(c)(1), (2), (3), or (4) [15 U.S.C. 3317(c)(1), (2), (3), or (4)].

(c) NATURAL GAS PRODUCED FROM 5,000 OR LESS.—Effective beginning July 1, 1987, or, if later, the date of expiration of any price controls reimposed under section 122 [15 U.S.C. 3332], the provisions of subtitle A respecting the maximum lawful price for any first sale of natural gas shall, except as provided in subsection (d), cease to apply to any first sale of natural gas produced from any new, onshore production well (as defined in section 103(c) [15 U.S.C. 3313]), if such natural gas—

(1) was not committed or dedicated to interstate commerce on April 20, 1977; and

(2) is produced from a completion location which is located at a depth of 5,000 feet or less.

(d) EXCLUSION OF CERTAIN ALASKA NATURAL GAS.—The provisions of subsections (a) and (c) shall not apply to any natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(e) LIMITATION ON INDEFINITE PRICE ESCALATORS.—Natural gas which is not subject to maximum lawful prices under subtitle A solely by reason of subsection (a)(3) and which is sold under any existing contract or successor to an existing contract at a price established under an indefinite price escalator clause (as defined in section 105(b)(3)(B) [15 U.S.C. 3315(b)(3)(B)]) shall be subject to the provisions of section 105(b)(3) [15 U.S.C. 3315(b)(3)].

SEC. 122 [15 U.S.C. 3332]. STANDBY PRICE CONTROL AUTHORITY.

(a) REIMPOSITION OF PRICE CONTROLS.—The President, in accordance with subsection (c)(1), or the Congress, in accordance with subsection (c)(2), may reimpose maximum lawful prices for first sales of natural gas to which section 121(a) [15 U.S.C. 3331 (a)] applies and delivery of which occurs after the effective date of the reimposition of such maximum lawful prices.

(b) LIMITATIONS.—A reimposition of maximum lawful prices under this section—

(1) may not take effect earlier than July 1, 1985, nor later than June 30, 1987; and

(2) shall remain in effect for a period of 18 months.

(c) PROCEDURE FOR REIMPOSING PRICE CONTROLS.—For purposes of this section—

(1) PRESIDENTIAL REIMPOSITION.—Any exercise of authority by the President under subsection (a) shall be by written order issued after May 31, 1985, and, subject to subsection (b), shall take effect for the first month beginning after the first 30 calendar days of continuous session of Congress (as determined in accordance with section 507(b) [15 U.S.C. 3417(b)]) after a copy of such order has been submitted to each House of the Congress unless during such 30 calendar days of continuous session of Congress, the Congress adopts a concurrent resolution of disproval described in section 507(c)(1) [15 U.S.C. 3417(c)(1)].

(2) CONGRESSIONAL REIMPOSITION.—Any exercise of authority by the Congress under subsection (a) shall be by the adoption of a concurrent resolution after May 31, 1985, described in section 507(c)(2) [15 U.S.C. 3417(c)(2)] and, subject to subsection (b), shall take effect for the first month beginning after the date of the adoption of such resolution.

(d) MAXIMUM LAWFUL PRICES APPLICABLE UNDER REIMPOSITION OF PRICE CONTROL.—If maximum lawful prices are reimposed under this section on first sales of natural gas to which section 121(a) [15 U.S.C. 3331(a)] applies, the maximum lawful price under this section for any first sale of such natural gas delivered during any month shall be—

(1) except as provided in paragraph (2), the maximum lawful price, per million Btu's, computed for such month under section 102 [15 U.S.C. 3312] (relating to new natural gas); and

(2) the maximum lawful price, per million Btu's, computed for such month under section 103(b)(2) [15 U.S.C. 3313(b)(2)] (relating to new, onshore production wells 5,000 feet or less in depth), in the case of

natural gas produced from any new, onshore production well (as defined in section 103(c) [15 U.S.C. 3313(c)]) if such natural gas—

(A) was not committed or dedicated to interstate commerce on April 20, 1977; and

(B) is produced from a completion location which is located at a depth of 5,000 feet or more.

(e) ALLOWANCE FOR STATE SEVERANCE TAXES AND CERTAIN PRODUCTION-RELATED COSTS.—A price may exceed the maximum lawful price applicable for such natural gas under this section to the same extent as is provided under section 110 [15 U.S.C. 3320] with respect to maximum lawful prices under subtitle A.

(f) LIMITATION.—Maximum lawful prices may be reimposed only once under this section.

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